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INSTALMENT SELLING

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FOREWORD

In 1927, the phenomenal extension of instalment credit in the sale of consumer goods was matter to view with alarm or to note with satisfaction. Debate among the economists was spirited. By 1931, the rival camps were finding in the depression proof of their conflicting views—the one school insisting that instalment credit had accentuated the violence of the business cycle, the other observing with gratification the ability of this credit to withstand the extraordinary strains to which it was then subjected. Now, in 1935, interest in this controversy seems to be ebbing. The volume of instalment credit is expanding once more, and new commodities are being brought within its compass. The instalment credit sale is a *fait accompli.*

But interest in instalment selling has not subsided with the waning of efforts to categorize it as a force for good or evil in our economy. Instead, the focus of attention has shifted to its operation. Does this vast credit machinery, designed for the dispensing of billions, function satisfactorily? Is the time purchaser paying a reasonable price for the benefits which he secures or is he the object of exploitation? Does the structure of legal rules which has been converted to the uses of mass sales financing operate efficiently for the seller and equitably for the purchaser? These questions are prompting legislative inquiry and have already led to the enactment of a few regulatory measures. They are becoming increasingly the concern of students of merchandizing and credit problems, in their legal as well as social and economic aspects. The industry is conscious of their significance.

This issue is devoted to the consideration of certain phases of the problems of the modern retail instalment credit sale. Comprehensive an undertaking of this character cannot be. The retail sale is but the culminating step in an integrated economic process, many aspects of which, especially wholesale financing and manufacturer-dealer relationships, have important bearings on the topics selected for discussion. Moreover, the device of the instalment credit sale is employed by industries too numerous and too diverse to permit adequate treatment of the problems peculiar to each. It is obvious that the credit sale of a new automobile, handled by a finance company which must have regard for dealer goodwill, presents problems distinct from the operations of the vendor of questionable chronometers who stations himself at the factory gate on pay-day. But the area of problems is broader than that of

abuses, and the fact that large segments of the field of instalment credit selling are free from sharp practices does not render them any the less a fruitful field for study.

The symposium is directed toward two major problems: financing charges and the enforcement of instalment credit obligations. After an introductory article by Professor Nathan Isaacs depicting the relation between the development of instalment selling in modern business and the law, the problem of financing charges is introduced by Mr. Raoul Berger's article, "Usury in Instalment Sales." Mr. Berger's thesis is challenged as economically unsound in the succeeding article, "Commentary on 'Usury in Instalment Sales'," a comment prepared by Mr. Stanley B. Ecker of Commercial Investment Trust, Inc., at the request of the editor. Dr. William T. Foster, Director of the Pollak Foundation for Economic Research, which has been active in the study of the instalment credit sale and in sponsoring legislation for its regulation, and Mr. LeBaron R. Foster, the Associate Director, have collaborated in the discussion of "Rate Aspects of Instalment Legislation." In that most important branch of instalment selling, the automobile industry, certain competitive practices among finance companies have tended to add to the burden borne by the consumer. This has been recognized by the industry itself, and its unsuccessful efforts to put its house in order through the medium of an NRA code are discussed in "The Consumer's Stake in the Finance Company Code Controversy," by the editor.

Turning to those problems which relate to the legal remedies of the instalment seller, Mr. M. William Adelson has undertaken a depiction of "The Mechanics of the Instalment Credit Sale," surveying the operation of legal rules and contractual provisions in the light of business practice, chiefly in the merchandizing of automobiles. A helpful commentary on Mr. Adelson's article has been secured from Mr. Joseph Myerson of Commercial Investment Trust, Inc., "Practical Aspects of Some Legal Problems of Sales Finance Companies." The chicanery which has invaded some branches of instalment selling and the work of an important agency for consumer protection are described in "Better Business Bureau Activities in Aid of the Time Purchaser" by Mr. Edward L. Greene, General Manager of the National Better Business Bureau, Inc.

The enforcement of small claims against the lower-income groups is a task for which conventional judicial machinery is ill-devised. Mass consumer credit has accentuated this problem. The City of Detroit has provided a laboratory wherein several experiments directed toward its solution are in process. These are described in "Devices for Liquidating Small Claims in Detroit" by Mr. Rolf Nugent, Director of the Division of Remedial Loans of the Russell Sage Foundation. The operation of the most important of these devices is illustrated in "Instalment Sale Contracts in the Detroit Conciliation Court," a series of case studies by Miss Mary Henderson Risk of the Russell Sage Foundation, which illumine not only the problems of collection but also throw light on the buying habits of time purchasers.—D. F. C.

INSTALMENT SELLING: THE RELATION BETWEEN ITS DEVELOPMENT IN MODERN BUSINESS AND THE LAW

NATHAN ISAACS*

Instead of asking, as many do, why instalment selling has come to be characteristic of the retail business in many lines today, perhaps we shall do well to invert the question and ask why the extensive development of such a practice has been postponed in business history to the current generation. Every element in the machine is old; perhaps it would be hard to discover novelty in the combination. The sale of goods to consumers on credit is as old as the tally sticks of the mediaeval innkeeper, or older. The arrangement that a debt shall fall due in a series of payments long antedates such fantastic names as "easy payments" or "budget plan"—its use for the purchase of houses antedates legal memory. The security phase, particularly the idea of making a hold on the thing sold the basis of safety, is obviously suggested by the analogy of real estate transactions. The early beginnings of a combination of these ideas in the sale of chattels is an obscure and yet inviting problem in business history. But at least we may venture the statement that the whole plan was invented and in use in limited fields more than a half century before its modern expansion began. In the middle of the 19th century, furniture, pianos, sewing machines, and books were sold under well-developed instalment plans. Why, then, the delay in the introduction of this tempting mode of overcoming sales resistance and of anticipating future earnings, from the seller's point of view, and of enjoying the thing purchased while paying for it, from the point of view of the buyer?

At first sight it may seem that the explanation is to be sought in the state of the law. Parallel attempts have been made to relate the whole evolution of credit to legal history. But such efforts have generally revealed two startling discrepancies: first, that where credit devices are wanted and the law fails to grant them, human ingenuity has frequently worked out pseudo-legal or extra-legal sanctions for them; secondly, that when such devices are not wanted they lie unused in the law for centuries after they are provided. To illustrate the first discrepancy, we have only to turn to the early law of pledges and liens, which in most countries came into

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existence independently of enforceable contracts. To illustrate the latter, we have only to recall that the legal foundations for our credit system were complete in the early 1600's, when the understanding that "every contract executory imports in itself an assumpsit," provided a simple action for the collection of debts of all kinds in the ordinary courts. But it would be vain to look for anything like the modern credit system in 17th century or even 18th century business. What we are concerned with here is only a specific application of this generalization. The legal instrumentalities that have been found useful in the development of instalment selling are not new.

We must therefore find the explanation of the delayed development of instalment selling in economic, social and psychological terms largely outside of the law. Some of these elements are obvious, but others are too subtle for statement, too hazy to be photographed, too slight to be ponderable.

Economists and other specialists have given much attention to the study of these aspects of instalment plans, though they have usually approached the matter from the other end—the easy end of explaining why there has been a recent development. I shall not attempt to give new answers here, but merely to recast some of the questions—in deference, if you wish, to the success of their demonstrations.

(1) Why didn't the manufacturers of carriages and the manufacturers of the first automobiles, or the predecessors of the manufacturers of the various gadgets that fill modern commerce, resort to the obvious method of selling on time? (2) Again, a second question may be considered together with the first: What other methods or substitutes were available to accomplish the same business and social ends as have been accomplished since the World War by instalment selling, and why have these failed to continue to solve the difficulty?

Any answer to these questions involves a consideration of some of the following elements: (a) the types of purchaser; (b) the types of article; (c) the conditions of competition and the practices of trades; (d) popular prejudices; (e) the presence or absence of facilitating institutions; (f) the legal environment or setting. A word as to each of these elements, though they do not make up a logical list in that they are neither exhaustive nor mutually exclusive, will reveal the part played by the law both directly and indirectly in the changes that have already come about, and may throw some light on the future.

(a) We might dismiss the discussion of types of purchaser with the remark that as an incident to a higher standard of living or a more extravagant mode of living, more people of small means buy cars than ever thought of buying horses and carriages. Not only do the newer buyers need more credit, but they have less personal basis on which to ask for it. The resulting tendency is obvious. We should also bear in mind, however, the transition from the simple system of a maker selling to a consumer from his neighborhood, to that in which the national manufacturer passes goods through the hands of the middleman whose sole job is to sell. The

credit experience of a tailor who makes clothes to order for his clientele is quite different from that of the seller of ready-made clothing. The former reflects the general conditions of a century ago; the latter, the prevailing marketing conditions of today. It is hard to conceive just how instalment selling can be grafted on the former or that it would be at all desirable. The plan has found its place in the less personal touch-and-go relation of the latter system, even for commodities as ill-fitted to it in most respects as clothing.

(b) As to the types of articles: obviously there must be a second-hand market, otherwise there is no basis for security in them. It must, furthermore, be an established second-hand market, and not merely a disordered junk market. Goods lending themselves to reconditioning fit this purpose most readily. Such goods also have a trade-in value. In the 19th century the best examples were sewing machines and pianos. Today the automobile takes first rank. Household furniture, radios, and electrical equipment rank lower in this respect. But conditions change. It is not long since a "second-hand" automobile—the term has of course been displaced on the market by the more euphonious "used car" or "traded-in-car"—was wisely shunned except by the amateur mechanic. But standardization of parts and repairs, improvement in the cars themselves, the recognized habits of the trade, and, chiefly, reasonably satisfactory experience, have broken down much of this resistance and simultaneously built up the basis of automobile financing. Without such a basis, trade-in values are fictitious and financing is a sham in which prices must be set so high that the "down payment" is looked to to cover costs. If there are more articles in the market today than formerly to which the instalment plan is applicable, the reason is to be sought partly in the state of the corresponding second-hand markets, partly in the increase of sturdy, substantial, or reconditionable goods, and partly in the skill with which repossessed goods are handled. One other aspect of the goods may be mentioned here: some goods are more readily identifiable than others. Numbered engines or works and similarly identified articles lend themselves better to the protection devices than pieces of furniture that are as much alike as peas in a pod—a characteristic situation under mass production. Again, bulky objects like pianos present fewer difficulties than easily moved goods, particularly automobiles. These differences entail practical difficulties when we come to the application of legal machinery; they are not, however, insuperable. One other type of commodity lends itself to financing: fixtures that become a part of the realty. Of these we shall have a word to say in discussing legal machinery.

(c) Perhaps the simplest answer to our questions about the pre-instalment period is that business had not yet been driven to the instalment system. Intensity of competition was, of course, a factor in the development of automobile financing. The system operates as a high power method of selling electric refrigerators, furnaces, cash registers, farm machinery, and other expensive durable equipment. It is interesting to run through the N. R. A. codes of fair competition and note allusions there

to liberal credit terms as unfair, and yet to find "financing" so well established in certain industries that it is accepted in them as normal.

(d) Popular prejudice had to be overcome before instalment businesses could reach their present state. To this end the sellers and others interested resorted to petty advertising and sales tactics. They invented fancy names for their plans. They drew up forms that were at once impressive and innocuous-looking. They avoided publicity as much as possible. But they also had to use common sense. The rates of interest, no matter how artfully concealed, could not go beyond certain limits. Nor could a business be built on the practice of continuing to collect instalments after an article had worn out. Theoretically, the seller looking to the thing for security could deal with all persons alike; practically, of course, he could not. With some people he obviously ran such risks as rapid deterioration, destruction, concealment, or removal of the goods, unpleasant publicity in the process of enforcement of claims, or even the confiscation for misuse of such articles as automobiles transporting liquor under prohibition. Of course, consumer credit is based more on the probable willingness and ability to pay than upon amenability to legal compulsion. Hence, the problem of introducing the instalment plan or using it in any given business always had its personal side which, though not appearing on paper or reflected in the legal set-up, sometimes spelled the difference between success and failure.

Of course the thrift habits of a community have a bearing on the social standing of the borrower. Education exerts an influence. In some types of communities, sharp distinctions are made between borrowing for consumption and borrowing for production. There are, indeed, borrower communities and lender communities in the country, each of which is equipped with its own *mores*. An important factor is the question of likelihood of being able to repay. But there are other factors: there are stages of community development in which saving has a tremendous social importance; there are perhaps others in which the encouragement of spending is necessary. In any event, whether wisely or not, Americans whose grandfathers regarded all luxuries askance and luxuries bought on credit as sinful, have no difficulty in persuading themselves that they are really engaging in wise compulsory saving when they buy such useful articles as electric washing machines, electric refrigerators, and, of course, automobiles, on the instalment plan. Didn't their grandfathers buy houses that way?

(e) In course of time the practices referred to became institutionalized. I use this term in the sense of being facilitated by specially devised and more or less standardized practices, forms, organizations. There is a vast difference between the puzzling course of two men planning an instalment sale between themselves, say in the transfer of a collection of books or a stock in trade, and the smooth path of signing the neatly prepared forms at the deferred-payment-plan window of an automobile salesroom. Standardization of practices operates here in several ways. It not only saves time and effort, but avoids embarrassment and the appearance of

asking for a favor; it destroys fear and sales resistance because of the reasonable assumption that the treatment accorded all comers alike has been fought out and tested and that it is on the whole tolerable. Of course abuses may be standardized, too, and agreements one-sided as to rates, risk bearing, waivers, and modes of enforcement may be drawn, but as a practice becomes established and its corners rubbed down by competition, this danger does decrease. But institutionalizing goes further than forms. It includes the development of other facilities, such as credit agencies for the investigation of consumer-purchasers and other systems for the exchange of information. It includes special departments or subsidiaries or separate companies organized to take care of this kind of business. It includes the training of specialists or the making of routine connections to handle every stage of the work down to repossession, reconditioning, and resale of the commodity sold. A part—a large part, perhaps—of the standardizing or institutionalizing falls to the lawyer.

(f) We have already said that the principal facilities furnished by the law for the instalment system were old when first thought of in connection with such a purpose. This fact might at first glance suggest that there was little for the lawyers to do but apply them. There is, however, another side to the story. Just because the devices had come into existence and had been crystallized with no thought of serving the modern objective, they were in a measure ill-suited to it and called for careful adaptation rather than simple adoption. This process has been accomplished in part by draftsmanship, in part by legislation, and in part by cutting the business according to the cloth provided by law.

Let us consider the credit security devices that were available. Of the two great divisions, personal security and real security, personal security in the sense of guaranty, suretyship, third party endorsement, and the like, has been ruled out because of its inconvenience and uncertainty. A distinction might be drawn between 19th century rural conditions and 20th century urban or quasi-urban conditions in America in this regard. In the former, the practice of acting as surety for a neighbor or relative or dependent less known in the community, or even vouching for him less formally, played a conspicuous part. In the latter situation, the large scale dealer knows no more about my neighbor's word than he does about mine. The relation becomes impersonalized, and the reliance on things rather than on persons for additional security is inevitable. Of the real security that is left us, we must avoid possessory holds, such as possessory liens and pledges, because while serving their security purpose they defeat the primary business purpose of the transaction by withholding the goods from use. There remain, therefore, what might be called title holds, such as those involved in chattel mortgages, conditional sales, leases, or other bailment arrangements with privilege of purchase, or trust receipts. Some of these are obviously too heavy for ordinary use. Thus, the idea of giving commodities to a trustee who issues certificates to those who furnish the money, and then renting to the user under an elaborate lease that takes care of principal and interest,

may serve for a railway's rolling stock but it just won't do for ordinary consumer credit. Hence, we are practically limited to the chattel mortgage, the conditional sale, and some form of "hire purchase" or leasing.[1] To make these safe for the creditor, lawyers have multiplied clauses adding to the scope of self-help on the part of the creditor, imposing waivers of exemptions and other rights and warrants to confess judgments on the buyer and passing every conceivable risk and expense on to him. On the other hand, laws have been enacted to make such clauses fairer from the buyer's point of view, and more reasonable from that of the general public. Among these laws, are, of course, usury laws, which sometimes need particular pointing to take care of interest hidden under the guise of fees, laws imposing formalities or at least publicity on the mode of foreclosure, laws limiting the amount of "rental" or other sums, however named in the documents, which are in reality forfeitures, and, in general, laws tending to standardize the terms of such agreements on an equitable basis. To protect the interest of the public, or at least to define its interest when that collides with the interest of the lien holder, the law provides in general for registration, filing, or otherwise destroying the secrecy of the lien as a condition precedent to holding it against the bona fide purchaser for value or, in some statutes, other claimants less clearly entitled to such protection. In the stage through which we are passing, there is a lack of uniformity, but no doubt as to the direction of progress. The Uniform Conditional Sales Act has been adopted in only nine states; the Uniform Trust Receipt Act in only one; the Uniform Chattel Mortgage Act in four. There is, furthermore, great diversity of opinion as to whether particular legislation on secret liens and registration applies to slightly different forms, such as the leases of the hire-purchase arrangement. And the difficulties and diversities become almost hopeless when we inject into the puzzle picture the possibility that the chattel sold may become a part of the realty. The question whether separate real estate and chattel records are desirable or effective without actual consents from owners or mortgagees of the real estate, must be resolved in the present state of the law individually for each state and almost for each type of fixture.

Besides resolving doubts of this kind, the future tasks of the law regarding instalment sales point in two directions: to perfect the machinery of legitimate instalment selling; and to check abuses.

The imperfection attracting most attention at present is the absence of a national registration system for automobiles. It was quite natural to have land titles and incumbrances registered locally in the county court house or some other convenient building. It was at first quite reasonable to copy this provision into the registration or filing of documents pertaining to movables. It was soon found necessary, however, to supplement such legislation by making it illegal to remove goods from the place of such registry without proper notices and consents. Nevertheless, cases did arise in which pianos and such bulky goods were removed and sold in other states to

[1] For a discussion of these security devices, see Adelson, *The Mechanics of the Instalment Credit Sale*, *infra*, at p. 227.

innocent purchasers. Holdings in favor of the mortgagee in such cases still left the buyer without any genuine means of looking up the title to goods offered him. He was thrown back on the common law risk. But when the automobile became the chief commodity dealt with in this way, the absence of a nation-wide record became serious indeed. The registries of motor vehicles in several states are armed with power to inquire into the history of a car as a condition precedent to issuing a license. This is a step in a direction in which we may expect legislatures to go further.[2] Other demands on the part of those who would make instalment machinery more effective go to the facilitating of recaption, to the punishment of various types of fraud or unfairness on the part of persons obtaining credit, and to the recognition of instalment financing and instalment paper in the banking world.

More attention, however, is directed towards the removal of abuses from the borrower's point of view. Besides developing such legislation as that already listed as showing the type of transition through which we are passing, we may expect the weeding out of procedural abuses, and the further adjustment of charges to a fair interest *plus* reasonable costs.[3] Whether legislation should at the present stage go further to stimulate, direct or check instalment buying is, of course, controversial in the highest degree. Depression studies run all the way from attempts to attribute the severity of the depression to unwise instalment buying and selling, to triumphant demonstrations that instalment selling has stood the test of depressions. What must be borne in mind, however, as we look forward to the future with legislative action or even self-regulation by trades in view, is that there is a difference between the sudden expansion of a practice without legal control, such as we witnessed in the 1920's, and its continued use in industries where it succeeds in establishing itself, with abuses pretty well checked—the condition we may look for immediately ahead.

[2] For a discussion of proposals for legislation in this field, see Myerson, *Practical Aspects of Some Legal Problems of Sales Finance Companies*, *infra*, at p. 250.

[3] For a discussion of proposals for legislation affecting rates, see Foster and Foster, *Rate Aspects of Instalment Legislation*, *infra*, p. 189.

USURY IN INSTALMENT SALES*

RAOUL BERGER†

If A, having no cash at hand, wishes to buy some furniture, three ways of financing the sale are available. (1) He may borrow from a third person and pay the seller in cash. (2) He may buy on the instalment plan at a credit price determined by adding the interest in a lump sum to the cash price. (3) Or, buying on the instalment plan, he may obligate himself to pay the seller the cash price, at an interest rate expressed as such. If the loan bears excessive interest[1] it is uniformly held usurious. If, in the second transaction, usurious interest is lumped in the credit price, it is nevertheless sustained on the ground that the vendor may set one price for cash and another for credit.[2] And because the third transaction is in substance like the second, the majority of courts conclude that, regardless of the form which the reservation of excessive interest takes, there can be no usury predicated upon a sale.[3]

Viewed from the standpoint of A, all three transactions are in essence the same and fulfill the same purpose; they enable him to gain present goods in return for his promise to pay in future goods. What are the logical and legal grounds for distinguishing between interest on a loan and interest on a credit sale, between interest expressly reserved and interest lumped in a credit price? Are these distinctions historically and economically sound? The problem is of more than academic interest because instalment selling has rapidly come to play a major rôle[4] in financing consump-

* Italics throughout are the writer's.

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[1] The writer employs the term "excessive interest" throughout the article in the sense of exceeding the rate of interest fixed by law for transactions to which the law is applicable.

[2] Hogg v. Ruffner, 66 U. S. 390 (1861); Gilbert v. Hudgens, 92 Colo. 571, 22 P. (2d) 858 (1933). For additional cases, see 66 C. J. 184; 27 R. C. L. 214.

[3] Tousey v. Robinson, 58 Ky. 663 (1859); Graeme v. Adams, 63 Va. 451 (1872); Reger v. O'Neal, 33 W. Va. 159, 10 S. E. 375 (1889). For additional cases, see 66 C. J. 184, 27 R. C. L. 214. A vigorous dissent is uttered by Evans v. Negley, 13 S. & R. 218 (Pa. 1825); Compton v. Compton, 5 La. Ann. 615 (1850); Mitchell v. Griffith, 22 Mo. 515 (1856); Borum v. Fouts, 15 Ind. 50 (1860), erroneously deemed to be overruled by Newkirk v. Burson, 28 Ind. 435 (1867); Hogg v. Ruffner, 66 U. S., 390 (1861); Diercks v. Kennedy, 16 N. J. Eq. 210 (1863); Callanan v. Shaw, 24 Ia. 441 (1868); Scofield v. McNaught, 52 Ga. 69 (1874); Fisher v. Hoover, 3 Tex. Civ. App. 81, 21 S. W. 930 (1893); People's Bank v. Jackson, 43 S. C. 86, 20 S. E. 786 (1895); Rosen v. Rosen, 159 Mich. 72, 123 N. W. 559 (1909); Compton v. Compton, 190 Ala. 499, 67 So. 395 (1914).

[4] CLARK, FINANCING THE CONSUMER (1930) 12: "The expansion of instalment credit from a volume of $600,000,000 to $4,000,000,000 a year in twenty years shows to what extent indirect credit is being given to the masses of the people." See 1 SELIGMAN, ECONOMICS OF INSTALMENT SELLING (1927) 1 *et seq.;* GOLDMAN, PROSPERITY AND CONSUMER CREDIT (1930).

tion. Our industrial system depends upon mass production; mass production in turn demands a mass market. As a corollary, "wide sales require wide credit—mass buying demands mass finance."[5] The wisdom of instalment selling may be a matter of controversy,[6] but its continued existence as an important economic factor, even since the "crash," is an indisputable fact.[7] This rapid expansion of instalment selling has left a wide area of credit abuses uncontrolled.[8]

The judicial exclusion of credit sales from the operation of usury laws is one of the phenomena resulting from the bias of courts against usury legislation. That bias is a complex of many factors, chief among which are the judicial tendency to adopt a construction that prevents a forfeiture,[9] the impact on judicial interpretation of the *laissez faire* doctrine that a man may do as he will with his own,[10] the unscientific nature of a uniform statutory interest rate, coupled with a perception of the fact that not all credit transactions stand in need of social control. A statutory maximum rate, as was first pointed out by Turgot, is unscientific; it does not take cognizance of the wide variation in costs and risks of making loans; nor does it recognize the re-

[5] CLARK, *op. cit. supra* note 4, at 2.

[6] Lubin, *What Delays Revival* (1931) 67 NEW REPUBLIC 92; Ayres, *Instalment Debt and Business Revival* (1931) 67 NEW REPUBLIC 288 (A reply to Lubin, with rejoinder). *The Anticipated Dollar* (Jan. 1933) 7 FORTUNE 68, concurs with Ayres in the statement that the "average installment contract was for one year. Hence the outstanding installment debt has been liquidated several times since the crash."

[7] Froman, *Cost of Instalment Buying* (1933) 11 HARV. BUS. REV. 227, believes that about "15% of all goods bought at retail are purchased on the installment plan. This is exclusive of houses, life insurance, and stocks and bonds. . . ." *The Anticipated Dollar, supra* note 6, lists the total of instalment credit in 7 industries at $1,500,000,000, divided as follows: Automobiles, 62.5 per cent; electric refrigeration, 90 per cent; radio, 75 per cent; furniture, 70 per cent; sewing machines, 90 per cent; vacuum cleaners, 85 per cent; furnaces, 80 per cent. A news item on the financial page of the *Chicago Daily News*, Dec. 26, 1934, states that instalment buying is on the increase.

[8] Nugent and Henderson, *Instalment Selling and the Consumer: A Brief for Regulation* (1934) ANNALS 93, 101-102: "The goods and services customarily sold on installments have been associated with highly competitive markets of the laissez faire class. The sale of credit, on the other hand, has long been recognized as a function requiring supervision for the protection of the consumer. But by combining the two services, the sale of credit has escaped any vestige of supervision. . . . The necessitous and unthinking borrower has been protected in the majority of states by the licensing, bonding, and supervision of persons engaged in making small loans. The rise of installment selling has opened wide gaps in this regulatory armor and exposed large groups of consumers to abusive practices." See Whitaker, *Finance Company Racket* (1931) 23 AM. MERCURY 433; Foster, *To Tell You the Truth* (1933) 152 ATL. MONTHLY 321; Foster, *Easy Payments, A Fable for Consumers* (1934) 95 SCRIBNER'S MAGAZINE 47. In *Rate Aspects of Instalment Legislation, infra*, p. 189. Dr. Foster urges that instalment credit rates be expressed in terms of an interest rate on the unpaid balance.

[9] No citations are needed to support the well-known proposition that courts favor a construction which precludes a forfeiture. A few familiar examples will serve to illustrate the tendency. Courts construe an instrument as a chattel mortgage rather than as a conditional sale, in order to preserve a right of redemption; or a devise is interpreted to contain a covenant instead of a conditional limitation, to prevent forfeiture.

[10] The extent to which *laissez faire* doctrines influenced 18th and 19th century usury concepts is best illustrated by the words of Bentham: " . . . no man . . . acting freely and with his eyes open, ought to be hindered, with a view to his advantage, from making such a bargain, in the way of obtaining money, as he thinks fit; nor (what is a necessary consequence) anybody hindered from supplying him, upon any terms he thinks proper." Bentham, *Letters in Defense of Usury* (1816) 9 WORKS (Bowring's ed. 1839) 1. 8 HOLDSWORTH, HISTORY OF ENGLISH LAW (1925) 100: " . . . this century has seen the state resume a control, which it had abandoned under the influence of the a priori theories of Bentham, and of the pseudo-scientific laws of the school of *laissez faire* economists."

sponsiveness of money rates to scarcity and abundance.[11] Moreover, as Bentham noted, a statutory maximum fails of its purpose for it does not actually control the market rate of interest.[12] In response to such argument, England removed all bars to interest-taking in 1853.[13] Only a half-century was needed to show that the necessitous borrower could not be left to the untrammeled exactions of the lender;[14] consequently, various statutes seeking to remedy this defect were enacted.[15] The states, while retaining the general statutory maximum, have attempted to grapple with the problem by Small Loans Laws, which recognize the plight of the needy borrower and enable the lender to obtain a return commensurate with the costs and risks of making small loans.[16] Credit sales, however, have been handled by the courts, and, impelled by the factors above enumerated, the courts have adopted a policy that has made usury legislation an insignificant factor in the regulation of the practices attendant upon instalment selling. Even in the minority states which strike down the express reservation of excessive interest on a sale, the statute may be evaded merely by adding the interest to the cash price to form a credit price. As a result, credit sales now enjoy practically complete immunity from regulation, and there have been many instances of glaring credit abuses.[17]

[11] TURGOT, MEMOIRE SUR LES PRETS D'ARGENT, §36; STEPHENS, LIFE OF TURGOT (1895) 70.

[12] Bentham, *op. cit. supra* note 10; RYAN, USURY AND USURY LAWS (1924) 52-57.

[13] 15 & 16 VICT. c. 90. (1853). For summary of English Usury Acts, see 14 ENCYC. OF LAWS OF ENGLAND 408.

[14] 8 HOLDSWORTH, *loc. cit. supra* note 10: "In this country a very short experience of the consequences of allowing lenders and borrowers to make what bargains they please has been sufficient to demonstrate this fact; [i.e. that social control is essential to save those in need of pecuniary assistance from grievous oppression] and this century has seen the state resume a control. . . ." The statement by Lipscomb, C. J. of Alabama, after he had witnessed the consequences of repeal, further illustrates the point. "It was feared that much of our monied capital would leave the country if the restrictions imposed by the Act of 1805 should not be removed. It was again and again asked [re-echoing the Benthamite arguments] why not permit the holder of money to sell or hire it for the best price it will command—nobody ever thought of restraining the planter in the sale of his cotton, or the farmer of his grain—why should not contracts for the loan of money be as free and unrestrained. I was a member of the Legislature when the act of 1818 [removing restrictions on the taking of interest] was passed, and was prepared to give it all the support in my power. . . . Although I cannot now see any objection to it in theory, I readily admit that its effects have been deleterious in the extreme." Henry v. Thompson, Minor 209 (Ala. 1824).

[15] English Money Lender's Act, 63 & 64 VICT. c. 51 (1900).

[16] For Uniform Small Loans Law and Digest of the State Small Loans Laws, see RYAN, *op. cit. supra* note 12, at 222-231, and, for discussion of such laws, at 127-157. It is worth noting that competition has reduced the interest rate collected under such laws. CLARK, *op. cit. supra* note 4, at 227: ". . . the profitable conduct of this business . . . in states with a 3 per cent maximum and the reduction to 2½ per cent by the Household Finance Company . . . raise the presumption that 3½ per cent may now be higher than is economically necessary."

[17] See INDIANA DEPT. OF FINANCIAL INSTITUTIONS, REPORT ON INDIANA CONSUMER FINANCE AGENCIES (1934) App. II, which quotes from the report of an investigation by the Pollak Foundation for Economic Research. There interest charges are found running as high as: 51.8 per cent on mechanical refrigerators; 55.5 per cent on furniture, 93.3 per cent on radios, 106.1 per cent on auto tires (where the dealer quoted a rate of 10 per cent), 68.6 per cent on domestic ranges; 103.7 per cent on men's suits. However, the standard, high grade finance companies' rates on long term contracts are considerably lower. Froman, *supra* note 7, at 228, as an example of high rates, cites the purchase "of a $20 article . . . from one of our largest mail-order houses" where the interest rate runs to 86.6 per cent. He later comments that "some firms advertise, 'No increased charges for time payments'. In most cases such firms are either deceiving their

In view of the movement, which is gaining momentum, to subject instalment selling practices to control, it seems desirable to reëxamine the economic and historical bases for making the distinctions which courts have followed in the application of usury statutes, and to consider whether there may not yet be a part to be played by such statutes in the present movement.

SOCIAL AND ECONOMIC FACTORS

Any attempt to appraise the propriety of the distinction between a loan and a sale on credit must take into account the social purpose that has fostered usury legislation. It is frequently said that this purpose is the "prevention of extortion and unjust oppression by unscrupulous persons who are ready to take advantage of the necessities of others."[18] While such dicta may be susceptible of the interpretation that the courts will intervene to declare a loan usurious only when the borrower was driven by desperate necessity, the practice is to the contrary. The courts do not weigh the degrees of necessity which impel a borrower to seek a loan. If excessive interest is reserved, a loan to pay for household necessities and one to pay for a yacht are equally usurious. It is to be noted also that early usury laws did not purport to protect only the seeker after credit who borrowed money in order to keep the wolf from the door; on the contrary they outlawed all transactions where interest was taken.[19] An apt illustration is furnished by the statute 21 Jac. I, the preamble reading, "Whereas . . . divers subjects of this kingdom, as well the gentry as merchants, farmers and tradesmen, both for their urgent and necessary occasions, for the *following their trades, maintenance of their stocks,* have borrowed money, wares, etc."[20]

It may be said that in construing a modern usury statute, although the court must follow the letter of the statute when its meaning is clear and loans must therefore fall within its purview regardless of the necessities of the borrower, the fact that the greater number of instalment sales, *i.e.* the lump credit price transactions, are not strictly within the letter of the statute, and are not entered into under pressure of necessity, could be urged as a ground for excluding this type of transaction from its operation. Against this it may be argued that a very considerable number of such sales do present the element of discrepancy of bargaining power and, what is more important, this is not the only reason for subjecting such transactions to control. The greater opportunity for deception in the case of the credit sale may well be a circumstance that will offset the fact that in the total of such transactions economic pressure plays a less important part.

That such opportunity for deception does exist is evident. High pressure sales methods, advertising often deceptive in nature, inveigle that segment of the popula-

customers or doing an injustice to their cash customers." Finance companies are loath to disclose their methods of computing interest charges. *Ibid.*

[18] State v. Griffith, 83 Conn. 1, 74 Atl. 1068 (1910); McArthur v. Schenck, 31 Wis. 673 (1873).

[19] For compact summaries of historical data, see 8 HOLDSWORTH, *op. cit. supra* note 10, at 100-110; PALGRAVE, DICTIONARY OF POLITICAL ECONOMY (1895) 429-432.

[20] 21 JAC. I, c. 17 (1623).

tion which can least afford to dissipate its purchasing power, into oppressive credit contracts which absorb a considerable part of that purchasing power in finance charges.[21] Present instalment practices often withhold from the buyer knowledge of credit costs or may mislead him as to such costs.[22] Such devices as the lump sum credit price may draw his attention away from the fact that, to take an extreme case, he is paying as much as 106 per cent for the cost of credit;[23] or the interest may be expressed at a low rate, yet because it is computed on the entire unreduced principal throughout the term, the interest charge may be from 20 to 40 per cent. The obscurity that surrounds actual credit costs further impairs the buyer's bargaining position because, lacking such information, he cannot compare that cost with credit costs at other agencies.[24] An ironical result is that the cost of instalment credit has become so high as to justify, in many instances, the lament of small loans agencies that, were the actual cost of credit not concealed from the buyer, he would prefer to finance his purchases through the medium of the *declassé* loan agencies.[25]

It may be inferred from a number of dicta that the risk of the seller is thought to be greater than that of the lender and that the seller is therefore entitled to excessive interest.[26] If such dicta have reference to the small loans agency, the comparison is unfounded, for the seller in fact occupies a position superior to that of the lender. Like the lender, he has in his possession signed instruments which can frequently be exercised summarily.[27] And by means of the reservation of title under a conditional sale, the seller obtains a "more powerful legal instrument . . . than it

[21] INDIANA DEPT. OF FINANCIAL INSTITUTIONS, *op. cit. supra* note 17, at 5.

[22] Nugent and Henderson, *supra* note 8, at 99: " . . . unfortunate consequences of this failure to state finance charges openly and intelligibly. First, price competition is ineffective. Increasing competition brings bonuses to dealers but no reduction in the price of credit service to the consumer. Second, the consumer is utterly unable to measure the price he pays for installment credit in terms of the advantages of saving and buying for cash . . . or of finding cheaper credit facilities elsewhere." CLARK, *op. cit. supra* note 4, at 133: " . . . the actual costs of installment credit to the borrower are concealed in a complicated tangle of . . . stating charges." See comment by Froman, *supra* note 17.

[23] See *supra,* note 17. Nugent and Henderson, *supra* note 8, at 99: "The Consumers' Advisory Board . . . recommended the inclusion of a provision in the Finance Company Code requiring the statement of finance charges both as a money charge and as a rate per month on the unpaid balance of the contract." The Board's recommendations are quoted in Foster and Foster, *Rate Aspects of Instalment Legislation, infra* at p. 193. The indignant protest by the finance companies is set forth in 167 PRINTER'S INK 17, May 17, 1934.

[24] *Supra* note 22.

[25] CLARK, *op. cit. supra* note 4, at 188.

[26] Commercial Credit Co. v. Tarwater, 215 Ala. 123, 110 So. 39 (1926) ("there are elements of risk incident to such transactions."); Ricker v. Fay Securities Co., 294 Pac. 732 (Cal. 1931) ("other considerations than interest are properly involved, such as the risk incident to financing the contract."); *In re* Bibbey, 9 F. (2d) 944 (1925) ("In calculating the amount . . . the chances of loss and failure to pay . . . taken in consideration. . . ."). But see GOLDMAN, *op. cit. supra* note 4, at 67-68: "Mr. John J. Raskob, the organizer of the General Motors Acceptance Corporation . . . has said that while the General Motors Acceptance Corporation had handled $819,203,000 of consumer obligations during the preceding seven years, the entire total of loss was $1,117,706, or only *One-seventh of One Per Cent*. . . . The loss experience of General Motors Acceptance Corporation fairly well defines the measure of loss sustained on instalment sales in other industries." While this is a finance company loss and the dealer loss may run higher, CLARK, *op. cit. supra* note 4, at 141, agrees that the losses from uncollectable accounts have "turned out to be negligible for all classes of consumer credit agencies."

[27] Nugent and Henderson, *supra* note 8, at 100-101.

would have if it held a chattel mortgage," the chattel mortgage, according to the same authority, securing "90 per cent in number of all [small] loans."[28] The retaken goods, where the vendor has judiciously selected his risks and required an adequate down payment to cover depreciation costs, may well satisfy the balance due.[29] Incidentally, the forfeiture of all down payments, which attends default and recapture, has also effected a detrimental change in the buyer's position.[30] Thus, the "weaker position" of the seller is a fiction which furnishes no excuse for excluding the sale from the ambit of usury laws.

Little support is afforded by underlying economic realities for drawing a fine legal distinction between interest on a loan and interest on an instalment sale.[31] From an economic point of view, the credit sale and the loan are alike in nature.[32] In each, one party is seeking to gain present goods in return for a promise to pay in future goods. In a loan, money, a token exchangeable for either present or future goods, is given to the borrower.[33] In a sale on credit, the goods themselves are given to the vendee. Both transactions result in a contract for the future delivery of money.[34] Repayment is thus in the same medium of exchange, money, the interest on which is in each instance capable of being calculated on a fixed basis.

There is a difference, it is true, in that the seller will normally look to the profit in his merchandising transaction for his principal compensation, whereas the lender's remuneration comes solely through the interest charged. It may be thought, therefore, that the need of the seller to turn over goods will exercise a constant limitation on his desire to exact excessive credit terms. That the desire for a great turnover does not necessarily mean low interest charges is shown by the fact that "one of our largest mail order houses" reserves as much as 86 per cent to finance a five month credit sale.[34a] Moreover, the separate financing corporations that are quite common in fields where the volume of credit sales is large are actuated by motives scarcely distinguishable from those of a lender. At any rate, the results in practice show that

[28] See INDIANA DEPT. OF FINANCIAL INSTITUTIONS, *op. cit. supra* note 17, 41, 14.

[29] SELIGMAN, *op. cit. supra* note 4, at 205; GOLDMAN, *op. cit. supra* note 4, at 60.

[30] INDIANA DEPT. OF FINANCIAL INSTITUTIONS, *op. cit. supra* note 17, at 46. The Uniform Conditional Sales Act, sections 18-21, where it has been adopted, has effected a change in this respect. For a discussion of the rights of the seller and buyer on default under the typical automobile instalment sale contract, see Adelson, *The Mechanics of the Instalment Credit Sale*, *infra*, p. 218, at p. 233 *et seq.*

[31] Nugent and Henderson, *op. cit. supra* note 8, at 102: "One seeks in vain for a logical distinction between the installment and the cash loan contract, where persons of small income are concerned. The legal line of distinction is fine and the economic distinction does not exist."

[32] FISHER, ELEMENTARY PRINCIPLES OF ECONOMICS (1928) 394: "A loan contract is at bottom a sale . . . a borrower is a seller of a note of which the lender is the buyer. A bondholder is regarded indifferently as a lender and as a buyer of the bond."

[33] BÖHM-BAWERK, POSITIVE THEORY OF CAPITAL (4th ed. 1921) 296. Ryan, discussing the time-preference interest theory of Böhm-Bawerk, says, "In this theory of interest the loan is considered as an exchange or sale of present valuable things against future valuable things." *Op. cit. supra* note 12, at 65.

[34] SELIGMAN, *op. cit. supra* note 4, at 3: "Economically, the essence of credit is the temporary usance of wealth. A sale on credit is, from the economic point of view, no sale at all . . . credit becomes virtually a contract for the future delivery of money."

[34a] Froman, *supra* note 17, at 228.

the costs of financing sales are not always responsive to the pressure of turn-over, and that the profits at the financing end rival merchandising profits.[35]

HISTORICAL BACKGROUND

Usury laws ultimately trace back to the Biblical prohibition of all interest taking. The usury thus interdicted was the taking of any interest whatsoever upon any kind of transaction. "Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of anything that is lent upon usury."[36] "Thou shalt not give him thy money upon usury, nor lend him thy victuals for increase."[37] Adopted from the Bible by the Church Fathers, this blanket prohibition became a vital part of the Church teachings during the middle ages.[38] The spiritual concern with temporal matters was not merely confined to interest-taking. The Church condemned exploitation in any guise and sought to stamp out the avarice which prompted one to take advantage of the necessities of another. Coincident with the development of Church teachings on usury was the growth of the concept of "just price."[39] "The just price is not an arbitrary demand; as an extortionate dealer may obtain an absurd price when he sees that he can drive a hard bargain. . . . The just price is known by the common estimation of what the thing is worth."[40] In course of time the concepts of just price and usury became interwoven, and oppressive bargains of any nature came to be branded as usurious.[41] "Neither to scientific nor to popular opinion did usury carry in the middle ages and in the sixteenth century the specialized sense of excessive interest on a loan of money which the word bears

[35] The following excerpts are taken from an article which lauds the achievements of the finance companies in weathering the depression, and which may therefore be taken to represent the situation as it then existed. *Sales for Sale* (Jan. 1933) 7 FORTUNE 70. "One of the most prosperous corporate expressions of the installment-buying movement is Commercial Investment Trust Corp. of 1 Park Avenue, Manhattan. . . . In 1931, C. I. T. turned over $374,000,000. . . . On its $374,000,000 turnover, C. I. T. made a net profit of $7,554,998; the net being almost precisely 2 per cent of the volume. . . . Nearly every motor-car manufacturer operated in 1932 at a large deficit, yet—although the motor car itself supplied one of the most basic and probably by far the most profitable items in C. I. T.'s operations—the company continues to collect an excellent return (7.05 per cent) on its investment. Few companies listed on the New York Stock Exchange share with C. I. T. the distinction of having raised the common cash dividend since October, 1929, and having maintained the increase." A table on p. 74 discloses the following percentage of net to capital and surplus ["earned surplus has consistently increased and was as of June 30, 1932, nearly $14,000,000"]: 10.67 in 1927, 12.36 in 1928, 8.73 in 1929, 8.41 in 1930, and 8.57 in 1931.

[36] Deuteronomy, xxiii, 19, 20.

[37] Leviticus, xxv, 35-37.

[38] For citations to compact historical summaries, see note 19, *supra*; RYAN, *op. cit. supra* note 12, at 42.

[39] TAWNEY, RELIGION AND THE RISE OF CAPITALISM (1926) 32 *et seq.* "The unpardonable sin is that of the speculator or the middleman, who snatches private gain by the exploitation of public necessities." The "practical expression [of these ideas] was the body of economic casuistry in which the best known elements are the teaching with regard to the just price and the prohibition of usury."

[40] CUNNINGHAM, GROWTH OF ENGLISH INDUSTRY AND COMMERCE (4th ed. 1905) 252. For some interesting light on the genesis of sumptuary legislation, see *id.* at p. 250 *et seq.*

[41] 1 ASHLEY, ENGLISH ECONOMIC HISTORY AND THEORY (4th ed. 1906) 160: "The transition was easy from usury, strictly so called, to usurious practices in ordinary trade. Thus all payment of money in return for the giving of credit—all bargains in which goods were sold at a price higher than their real value in consideration of the seller's having to wait some time before he was paid—were deemed usurious." *Id.* at 161. "It is easy to see how the theory of usury, when it had once been developed to this point, would come to be interwoven with the theory of just price, until the one could in many doubtful cases be brought to strengthen the other."

today. . . . Any bargain from which one party obviously gained more advantage than the other and pressed his economic opportunity to the hilt was regarded as usurious."[42] The practice of selling dearer on time, using the device of an excessive credit price, was condemned by Pope Alexander III as early as 1176.[43] Gregory IX later declares in a decretal that "A man is to be accounted a usurer, not only if he charges interest, but if he allows for the element of time in a bargain, by asking a higher price when he sells on credit."[44] The papal decretals were a part of the canon law,[45] and, as Maitland points out, "in all probability large portions (to say the least) of 'the canon law of Rome' were regarded by the courts Christian in this country as absolutely binding statute law.[46] . . . I have looked in vain for any suggestion that an English judge or advocate ever called in question the statutory power of a text that was contained in any of the three papal . . ." decretals.[47] Additional evidence as to the attitude of the Church in England is furnished by a manual drawn *circa* 1450 for parish clergymen by John Myrc, a canon of a monastery in the West of England. "The parish priest is here instructed to tell his parishioners not only that usury itself is sinful—'to lend 12*d.* to have 13*d.*'—but also that to sell an article to a man at too high a price is just as bad. A form of excommunication is given and it includes all 'usurers that [in order to win] lend their cattall [cattle] till a certain day for a more price than it might have been sold at the time of the loan. . . ' "[48] Note that the word "lend" as applied to a chattel in a usury context expressed the modern notion of selling on credit.[49] One borrowed grain and other consumptibles that were not meant to be returned in specie; and we shall find the later statutes adverting to the lending upon interest of merchandise and wares as well as money,[50] in this sense of extending credit. Such credit transactions gave rise to the "problem of prices and interest. . . . The craftsman must buy raw materials on credit. . . . Even the cottager who buys grain at the local market must constantly ask the seller to

[42] Tawney, *Introduction* (1925) to WILSON, DISCOURSE ON USURY (1572) 122. (Hereafted cited as Tawney, *Introduction*.)

[43] 1 ASHLEY, *op. cit. supra* note 41, at 160. The "direct prohibition of such practices [appeared] first in a Bull directed by Alexander III in 1176 to the Archbishop of Genoa." Quoting the Decretal of Gregory IX, "Though contracts of this kind . . . cannot strictly be called usuries, yet nevertheless the venders incur guilt. Your citizens therefore will do well, for their own salvation, to cease from such contracts." TAWNEY, *op. cit. supra* note 39, at 48, apparently referring to the same practice in Genoa, translates "It is not clear that such contracts are necessarily usurious; nevertheless, the sellers run into sin, unless there is a probability that the wares will have changed in value by the time payment is made."

[44] *Id.* at 47. Note that Tawney throughout the page is referring to various sections of a compendious Decretal. Assuming that the early Genoese transaction was not deemed "strictly usurious" in 1176, the language of the text above justifies the inference that by the time of Gregory IX such transactions were forbidden.

[45] BOUVIER, LAW DICTIONARY, "Canon Law." "The *Corpus Juris Canonici* is drawn from various sources,—the opinions of the ancient fathers of the church . . . the decretal epistles and bulls of the holy see, together with . . . the teachings of the Scriptures."

[46] MAITLAND, CANON LAW IN THE CHURCH OF ENGLAND (1898) 2.

[47] *Id.* at 9.

[48] 2 ASHLEY, *op. cit. supra* note 41, 461.

[49] Leviticus, xxv, 35-37, employs the term in a similar sense. "Thou shalt not . . . lend him thy victuals for increase." The men who rendered the King James version of the Bible used the familiar term.

[50] See 21 JAC. I, c. 17 (1623); 12 ANNE, c. 16 (1714).

give day."[51] We shall not meet the phrase "buying on credit" in early law; instead, we shall encounter such phrases as the "lending of wares and merchandise" and the "giving of day" for such loans. This phrase the "giving of day" was the mediaeval counterpart of the modern "extension of credit"; the phrase and its synonym "forbearance" will later be found to play an important rôle in usury laws.

How far the common law was influenced by canonical concepts of usury is a question on which historical research has as yet shed little light; such studies as have been made have not focused on the problem now under consideration. It is not clear whether the sale at an excessive credit price, branded as usurious by the canon law, continued to be so regarded by the common law; there is no direct evidence on this point until 1821 when *Beete v. Bidgood* first presents the question squarely.[52] Possibly the canonical notion that an excessive credit price was usurious was swept away by the rising tide of commercialism. However, the *express reservation* of *excessive interest* on a credit sale stands on a different footing, as the section on statutory materials will seek to prove. Certainly in those commercial nations where the civil law had supplanted canon law, excessive interest reserved on sales continued to be regarded as usurious. We have it on the authority of the Louisiana court that "Interest stipulated on sales . . . is classed . . . with interest accruing on loans. . . . This principle is not an innovation in jurisprudence; it has descended to us from the Roman law. . . . It is recognized by many decisions of the court of France."[53] Although the argument—that the express reservation of interest on a credit sale continued to be governed by usury laws—will be rested largely on the internal evidence of the statutes themselves and on the precedents, there is some reason to think that the canon law as to usury was not without influence on the common law, and that the inclusion in the statutes of language aiming at credit sales may well have resulted from the canonical tradition which had for centuries cast its shadow over English life.

As early as 1178 the jurisdiction of usury cases was divided between Church and State; the king had cognizance of usurers dead, and the Church of usurers living.[54] This reservation of ecclesiastical rights was confirmed by the statute of 15 Edw. III, c. 5, in 1341, again by 13 Eliz. in 1570;[55] and was paid lip service at least by the statute of 21 Jac. I in 1623.[56] It is conceivable that the two jurisdictions may have had widely divergent views as to what constituted usury, and as Maitland says, "the king's justices . . . did not profess to administer the law of the church";[57] yet in view of the fact that the division of jurisdiction arose from the king's desire to obtain the

[51] Tawney, *Introduction*, *op. cit. supra* note 42, at 24.
[52] 7 Barn. & Cress. 453 (1821), 1 Man. & Ry. 143.
[53] Compton v. Compton, 5 La. Ann. 615 (1850). [54] ASHLEY, *op. cit. supra* note 41, at 384.
[55] 13 ELIZ. c. 8, §IX (1570). "Every such offender . . . shall and may also be punished and corrected according to the ecclesiastical laws heretofore made against usury."
[56] 21 JAC. I, c. 17 §V (1623). "No words in this law contained shall be construed or expounded to allow the practice of usury in point of religion or conscience."
[57] *Supra* note 46, at 75.

forfeited estates of dead usurers rather than because of any doctrinal breach, it is simpler to assume that the canonical concepts of usury, which had permeated English thought for generations, were enforced in both lay and church courts. In this connection, it is significant that the statute of 13 Eliz. declares that "all usury, being forbidden by the law of God is sin and detestable" and that every offender "shall and may also be punished and corrected according to the ecclesiastical laws heretofore made against usury." Then too, " 'the great compilations' of the civilians and the canonists were . . . 'the sole legal teaching that was to be obtained in the schools where Englishmen went to learn law'; and although the common law judges might not be canonists or civilians, 'the statesmen in many cases were.' The circumstance that the administrative officials had in England, as elsewhere, usually received some part of their training in canon or civil law . . . must necessarily have affected legislation and also the practice of the courts."[58] It is not going further than the facts warrant to say that canon law principles in regard to money lending and credit "set the precedents followed by secular authorities down, at least, to the third quarter of the sixteenth century."[59]

The first clear definition of usury found in an English statute is contained in 11 Hen. VII, and that definition forbids two transactions: the lending of money, and a sale at an excessive price where the vendor or his factor intend to repurchase the goods at a lower price.[60] From this definition it would seem to follow that when subsequent statutes speak of a "bargain and sale," they advert only to the foregoing device. However, the statute of 37 Hen. VIII repealed all prior laws on the subject of usury; and after a preamble setting forth that the previous enactments had failed to suppress "usury and other corrupt bargains," it proceeds to redefine usury in terms that for the first time permit the taking of interest. Section II of the statute sets forth in some detail the sale and repurchase by the vendor or his factor previously forbidden by 11 Hen. VII; while section III purports to enumerate other transactions wherein the taking of more than 10 per cent interest would be usurious. Amongst other things, that section states that "no person by way of any corrupt bargain, loan, exchange, interest of any wares shall take in lucre or gains for the *forbearing or giving day* of payment of one whole year . . . for his money that shall be *due for the same wares*" more than 10 per cent.[61] To argue that the words

[58] Ashley, *op. cit supra* note 41, at 384.

[59] Tawney, *Introduction, op. cit. supra* note 42, at 107.

[60] The Statutes at Large contain only what amounts to the title of 11 Hen. VII, c. 8 (1494). The statute is set out in full in the appendix to Comyn, Usury (Am. ed. 1834) 98. " . . . for the plain explanation . . . of usury . . . the King . . . enacteth . . . that . . . all persons lending money to and for a time taking for the same loan anything more besides or above the money lent etc. . . ., and that all persons which hereafter sell any goods . . . to any person . . . being in necessity, and the seller himself or by his broker or factor in that behalf again buy the same goods etc. . . . of the same person to whom they were sold . . . within three months after they be sold . . . for a less sum of money than they were sold for . . ." shall be guilty of usury. (The first edition of this work appeared in 1817.)

[61] 37 Hen. VIII, c. 9 (1545) Section II: " . . . no person . . . shall . . . sell his merchandise or wares to any person . . . and within three months next after, by himself, factor . . . or by any other person or persons to his use and behoof, buy the same merchandise or wares . . . upon a lower price,

italicised above refer again to the transaction already condemned in clearest terms in section II, is needlessly to rob the phrase "forbearing of money due for the same wares" of meaning, without in any way clarifying the unambiguous second section. And according to a recognized canon of interpretation we are forbidden to assume without a clear reason to the contrary that any part of so important a statute is superfluous.[62] If we nevertheless regard this phrase as surplusage and conclude that, except for the sale and resale forbidden by section II, no reservation of excessive interest on a credit sale was usurious, there would then have been no point in resorting to the elaborate sale and resale so unequivocally banned; for it would have been the safe and obvious procedure for the usurer, when besought to lend, to invest his money in wares of the value of 100 pounds and then to sell them to the borrower either for 200 pounds on credit, or for 100 pounds at 100 per cent. Additional support for the proposition that the usury laws were aiming at the excessive reservation of interest on a credit sale is furnished by the preamble and section II of 21 Jac. I. That statute reads "Whereas . . . divers subjects . . . as well the gentry as merchants, farmers and tradesmen, both for their urgent and necessary occasions, *for the following their trades, maintenance of their stocks* . . . do *borrow* divers sums of money, *wares, merchandise*," be it enacted that "no person upon *any contract* shall take directly or indirectly, for loan of any monies, *wares and merchandises* above 8 pounds for the forbearance of 100 pounds."[63] The borrowing of wares by merchants and tradesmen to maintain their stocks or for the following of their trades was a borrowing in the sense previously alluded to; it was the progenitor of the modern purchase on credit. The merchant who borrowed wool to make up cloth did not intend to repay in wool but in money. Had he intended to repay in wool, the transaction would have been without the bounds of usury law, for, to constitute usury, repayment must be in money.[64] The archaism "lending of wares" survives as late as 12 Anne,[65] and is thereafter taken over by the American statutes.[66] Finally, the statutes were implemented by the rule of construction prescribed by 13 Eliz., *viz.*, that the statute of 37 Hen. VIII was to "be most largely and

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knowing them to be the same wares or merchandise that he before did bargain and sell." Section III: " . . . no person . . . by way or mean of any corrupt bargain, loan, exchange, interest of any wares . . . shall take in lucre or gains for the forbearing or giving day of payment . . . for his money or other things that shall be *due for the same wares* . . ." above 10 per cent.

[62] Hurtado v. California, 110 U. S. 516 (1884). [63] *Supra* note 56, preamble, and §II.

[64] Van Schaick v. Edwards, 2 Johns. 355 (N. Y. 1801).

[65] 12 ANNE, c. 16 (1714). " . . . no person . . . *upon any contract made* . . . shall take directly or indirectly, for loan of any monies, *wares, merchandise* above . . . 5 pounds for the forbearance of 100 pounds, and *all* bonds, contracts . . . whatsoever made . . . shall be void; and all persons whatsoever, which shall upon any contract . . . by way or mean of any corrupt bargain, loan . . . or interest of any wares . . . for the forbearing or giving days of payment . . . shall forfeit. . . ."

[66] N. J. COMP. STAT. (1911), tit. "Usury," p. 5704, §1, "for loan of any money, wares, merchandise . . . [takes above] $6 for the forbearance of $100." ILL. REV. STAT. (Cahill, 1927) c. 74, "For the loan or forbearance . . . of any money, goods . . ." N. Y. CONS. LAWS (Cahill, 1930) art. 25, §373; "all contracts . . . whereupon . . . there shall be reserved . . . any greater sum . . . for the loan or forbearance of any money, goods."

strongly construed for the repressing of usury, and against all persons that shall offend against the true meaning of the said statute, by any way or device, directly or indirectly."[67]

If resort be had to the historical antecedents of the legal terms employed in the usury statutes, those terms will be found to embrace excessive interest on a credit sale. It will be recalled that 37 Hen. VIII declares, *inter alia*, that no person shall take excessive interest upon a loan or the "*forbearing or giving day of payment for his money* that shall be *due for the same wares*."[68] To elucidate the archaic language we turn to Coke, who defines usury to be a "contract upon a loan of money, or giving days for *forbearing of* money, *debt*, or duty, by way of a loan . . . sale of wares, or other doings whatsoever."[69] As thus defined, usury embraces a loan, and the giving of day for the forbearance of money or debt, by way of a loan or sale of wares. In short, usury may be predicated upon a loan, or the forbearance of a debt by way of a sale of wares. American authorities later paraphrased Coke's definition as the "loan of money or forbearance of a debt."[70] The phrase "forbearance of a debt" is not encountered in English or American statutes; the latter employ the less ambiguous expression "loan or forbearance of goods, money . . . ."[71]; but as the former definition appears to be generally approved, the writer accepts it as the basis of discussion. Since the extension of credit on a sale does not constitute a loan,[72] the taking of excessive interest on a credit sale can be regarded as usurious only if the extension of credit constitutes a "forbearance of a debt." It must therefore be established that the buyer's obligation was a "debt" in the sense in which the term was employed at common law; and that the term "forbearance" applied not only to the time of payment after maturity, but also to the actual extension of credit at the time when the debt was contracted.

Reference to the action of debt, which for centuries was the sole remedy by which the seller could enforce the buyer's obligation, discloses that the term "debt" embraced both the obligation arising on a sale and that resulting from a loan. The action of debt, at early common law, went for the recovery of a sum of money belonging to the creditor but in the possession of the debtor,[73] the duty to pay being imposed by law and arising independently of the promise.[74] Debt would also lie to enforce an obligation arising on a deed, and this by the fiction of "present grant," whereby the promise to pay a sum certain in the future was "conceived of as a present

[67] *Supra* note 55, §IX.

[68] *Supra* note 61.

[69] 3 INST. 150, c. 78.

[70] Tousey v. Robinson, Graeme v. Adams, *supra* note 3; Cutler v. Wright, 22 N. Y. 472 (1860); Ayres & Graves v. Ellis, 185 Ark. 818, 449 S. W. (2d) 1056 (1932); Davidson v. Davis, 59 Fla. 476, 52 So. 139 (1910); Commercial Credit Co. v. Tarwater, *supra* note 26; Hogg v. Ruffner, 66 U. S. 115 (1861).

[71] *Supra* note 66.

[72] Although authorities are not wanting that bring the credit sale within the term "loan." Evans v. Negley, *supra* note 3; Van Schaick v. Edwards, *supra* note 64, Henry v. Thompson, *supra* note 14. ORD, USURY (1st ed. 1797) 29. See also note 88, *infra*.

[73] LANGDELL, CONTRACTS (2d ed. 1880) §100.

[74] 2 STREET, FOUNDATIONS OF LEGAL LIABILITY (1906) 1.

grant of the sum; a transfer of title to the obligee which creates a *debitum in praesenti* albeit *solvendum in futuro*."[75] From this it was but a short step to regard the credit sale (which was not yet conceived of in terms of contract) as an exchange of values; in return for the sale of the goods the vendee made a "present grant" of the money.[76]

Although the action of assumpsit, which proceeded upon the promise, proved a more convenient remedy than debt, displacing it in course of time almost entirely as respects simple contracts,[77] the disuse of the remedy did not wipe out the underlying conception of liability upon which debt is based; nor did the duty to pay which is independent of the promise disappear. The obligation engendered by a simple contract continues to have a dual nature, one aspect of which remains a debt which arises instantly by operation of law upon the receipt of a *quid pro quo*.[78] It follows that a *debt* arose on a sale as well as on a loan;[79] and nothing to the contrary appearing, it may be assumed that Coke, who first employed the term in defining usury, used it in its age-old sense.

The meaning of *forbearance* varied at common law according to the context in which it was used, having one meaning when employed in a usury context, and a different meaning when used to signify the consideration for a promise. Examples of the latter connotation may be found in Comyns' *Digest*, under the heading "What will be a good consideration," subheading, "Forbearance of a suit."[80] So, in *Fish v. Richardson*, "F had a debt owing to him by the testator R on a simple contract; and came to the defendant and told him of it; who said, that if plaintiff would forbear suit against him for a time, he promised to pay him"; and it was held a "good promise."[81] In a usury context, "forbearance" was a term used interchangeably with, but having a wider meaning than, the term "loan." Thus Comyns cites the statute 37 Hen. VIII under the title "Usury," to the effect that "no person . . . shall take for forbearance of 100 *l.* or other things due for wares . . . above 10 *l.* per cent."[82]

[75] KEIGWIN, CASES IN COMMON LAW PLEADING (1924) 35.

[76] Ames, *History of Assumpsit* (1888) 2 HARV. L. REV. 53, 55: "A simple contract debt, as well as a debt by specialty, was originally conceived of, not as a contract, in the modern sense of the term, that is, as a promise, but as a grant. A bargain and sale, and a loan, were exchanges of values." WILLIS, ANGLO-AMERICAN LAW (1926) 130: "At first the English courts held that title could only be transferred by delivery and payment. Then they adopted the reciprocal grant doctrine, whereby they held that title might pass without delivery and payment if credit was given."

[77] The complete acceptance of assumpsit as a concurrent remedy can only be said to date from Slade's Case, 4 Co. 92b (1602). 2 STREET, *op. cit. supra* note 74, at 65.

[78] *Ibid.*

[79] 2 POLLOCK & MAITLAND, HISTORY OF ENGLISH LAW (1899) 212: "In its earliest stage the action is thought of as an action whereby a man 'recovers' what belongs to him. It has its root in the money loan. . . . The case of the unpaid vendor is not . . . essentially different from that of the lender; he has parted with property and demands a return."

[80] 1 COMYNS' DIGEST (5th ed. 1822) 294-296, tit. "Action upon the case upon assumpsit." (The first edition appeared 1762-1767).

[81] Yelv. 55 (1605). Waters v. Glasop, 1 Ld. Raym. 357 (1704): "Forbearance to arrest a debtor until after a particular day is a good consideration for a premise by a third person to pay the debt."

[82] 7 COMYNS' DIGEST, *op. cit. supra* note 80, at 608. 37 HEN. VIII is set out more fully *supra* note 61. For similar use of "forbearance," see 12 ANNE c. 16 (1704), and 21 JAC. I. c. 17 (1623). 13 GEO. III

Used in this sense, "forbearance" did not mean that one refrained from pursuing a remedy on a legal obligation already matured, but that one extended credit—*gave day*—for a stipulated period; and for this "forbearance" one was paid interest. This meaning of "forbearance" in a usury context is clearly established by an unbroken line of cases extending over a period of two hundred years, cases in which pleadings and judgments had used the word to mean that one forbore a debt from the very instant of its creation.[83] Typical of the cases is *Barnes v. Worlich*,[84] wherein the issue was whether there was usury because of the required payment of semi-annual interest before maturity. "Fenner and Yelverton held that it was, for when he *lends it for one entire year*, he *ought to forbear his interest for a year*." Popham, Gawdy and Williams held that it was not usury. "... But if he had agreed to *take his money for the forbearance instantly when he lent it*, that had made the assurance void."[85]

The definition relied upon by the majority of American courts to exclude the sale from the operation of the statute, and for which the ultimate authority cited is Ord, is that a "forbearance" means the "giving of a day for the return of the loan, or more properly signifies the giving of a further day where the time agreed upon is passed."[86] No earlier utterance of this definition, in a usury context, than that by Ord in 1797, has been found by the writer; Ord cites no cases to support the application of his definition to usury, and his argument shows in fact that his remarks were not directed to the exclusion of sales from the operation of the statute. He writes, "it is not unusual to speak of money lent upon bottomry, i.e. advanced upon the voyage of a ship ... in which case if the ship is lost the money is never to be repaid. ... But how can a bargain of this kind, with propriety be called a for-

(1773) c. 63, s. 30, prohibits any subject of his majesty in the East Indies from taking above twelve pounds "*for the forbearance* of 100 pounds for one year." Henry v. Thompson, Minor 209 (Ala. 1824) quotes the act of 1805, " . . . if more than $6 for the forbearance or giving day of payment of $100 for one year . . . shall be taken . . .", and, at 224, cites the Act of 1819, "No person shall upon any contract . . . take above . . . $8 for the forbearance of $100 for one year."

[83] Each of the following cases involved usury, and in each the court expressly gives the term "forbearance" the meaning of "giving day" from the moment of contracting the debt. Burton's Case, 5 Co. Rep. 69a (1591); Roberts v. Tremayne, Cro. Jac. 507 (1617); Grysell v. Whichcott, Cro. Car. 283 (1633); Lloyd v. Williams, 2 W. Black. 791 (1772): "The statute of 12 Anne is express that it is usury to take above 5 per cent for the forbearing or giving day of payment, which plainly has respect to a taking of the interest or *forbearance before the principal is due.*" Marsh v. Martindale, 3 Bos. & Pul. 154 (1802): "It was then proposed that M. . . . should advance . . . 4250 pounds and . . . discount a bill of 5000 pounds at three years [taking 750 pounds interest for three years]. . . . What is this but *forbearing for three years to take the sum of 4250 pounds*, for which forbearance he was to receive interest on 5000 pounds." See also COMYN, USURY, *op. cit. supra* note 60, at 32-36.

[84] Cro. Jac. 25 (1601), s. c. Yel. 30, Moore 644, Noy 41.

[85] The following American cases hold that a credit sale comes within the "forbearance of a debt." Henry v. Thompson; Mitchell v. Griffith; Borum v. Fouts; Hogg v. Ruffner; Diercks v. Kennedy, Peoples Bank v. Jackson, Compton v. Compton, all cited *supra* note 3; Hogg v. Ruffner, *supra* note 2.

[86] Dry Dock Bank v. American Life Ins. Co. 3 N. Y. 344 (1850) cites Ord. Graeme v. Adams, *supra* note 3, cites no authorites. This confusion by the majority of the two different meanings of "forbearance" furnishes an illustration of the tendency noted by Professor Cook, *"Substance" and "Procedure" in the Conflict of Laws* (1932), 42 YALE L. J. 333, 337: "The tendency to assume that a word which appears in two or more legal rules, and so in connection with more than one purpose, has and should have precisely the same scope in all of them, runs all through legal discussions."

bearance, where the day of payment itself may never come?"[87] Obviously, Ord was criticising the use of the term "forbearance" in reference to bottomry contracts, where, since there was no debt, repayment being contingent on the completion of the voyage, there could not properly speaking be a forbearance. That Ord, in proposing the definition, was not seeking to exclude the credit sale from the protection of the statute, is made emphatically clear by his analysis of the credit sale, which, he reasons, results in a loan and is thus within the statute.[88] Ord's definition, in the sense in which it was adopted by the majority courts, is thus seen to be a departure[89] from a meaning firmly established by judicial precedent. To recur to 37 Hen. VIII, which speaks of the "forbearing of money due for wares," since it is a cardinal tenet of statutory construction that the words employed in a statute are to be given the meaning with which they were used at common law, or which they acquired through judicial interpretation,[90] it follows that a sale on credit, wherein the interest is expressly reserved, is within the statutory language. By parity of reasoning, the common law terms "forbearance of a debt," first employed by Coke, must likewise be taken to embrace such a credit sale. Technically, that phrase is not applicable in the situation where the "debt" is the lump credit price fixed by the seller, on which, ordinarily, no further excessive interest is charged. But inasmuch as the lump credit price, which has been fixed with the intention of exacting excessive interest, is merely a device employed to evade the usury law, it would seem that such transactions should come within the prohibitions of usury legislation.

ENGLISH PRECEDENTS

In the light of the statutory materials and of the historical background of usury legislation, it might be expected that there would be many precedents involving usury in credit sales. There are frequent dicta, but the first case the writer found that passes squarely on the express reservation of interest in a credit sale, is *Dewar v. Span* in 1789.[91] Dicta to the effect that a "*bona fide sale*" is not usurious will be found

[87] ORD, *op. cit. supra* note 72, at 24.

[88] *Id.* at 29, "If on a sale the purchase money is allowed to be retained by the vendee, to be paid at a future time, a debt is by that means created, yet that debt arises from a supposed lending. If the transaction to which it owes its existence is analyzed, it will be found to be compounded of two distinct contracts; first, a sale, which contrary to the real fact supposes the purchase money to be paid; and then a loan by the vendor to the vendee. The debt is founded on the latter contract. If we give this latitude to the meaning of the term, it will prove a true maxim, that there must be a loan to constitute usury."

[89] The New York Court, one of the first to enunciate the majority view as to the definition of forbearance, has made a ruling in a mortgage case which is inconsistent with that definition. In Ganz v. Lancaster, 169 N. Y. 357 (1902), a grantee had purchased premises *subject to* a mortgage. On maturity, the mortgagee, as a condition of extending the mortgage at illegal interest, required the grantee *to assume* the mortgage. The Court of Appeals held the contract usurious. One who purchases *subject to* a mortgage is not personally liable; as to him there is no debt until he *assumes* the mortgage. True, the land to which he claims title is chargeable with the mortgage, but his other assets cannot be pursued. Thus there was no forbearance under the majority definition because there had been no giving of time after the maturing of the *grantee's* debt.

[90] U. S. v. Trans-Missouri Freight Assn., 58 Fed. 58 (C. C. A. 8th, 1893); People v. Covelesky, 217 Mich. 90, 185 N. W. 770 (1921).

[91] 3 Term. Rep. 425 (1789).

scattered through cases involving the purchase of annuities, which turn on the principle that since the grantor of the annuity runs the hazard of never receiving his principal back, the contract is exempt from the operation of the statute.[92] This result harmonizes with the fundamental usury axiom: to constitute usury there must be certainty of repayment. Other cases say that if the sale occurs "in the course of trade" it is not usurious.[93] First met in 1702 in the inexplicable case of *Yeoman v. Barstow,*[94] this dictum arose as follows. Plaintiff sold to defendant 300 pounds in pieces of hammered silver English money "the coin of the realm and in consideration that plaintiff would pay defendant the aforesaid money, defendant undertook to pay 300 pounds in new milled silver English money together with" excessive interest. The court found that there was a custom in the trade to engage in such transactions, that the contract "arose in course of trade," and that "there was no loan and without that there can be no usury." It suffices to cite the remarks of Lord Alvanley when that case was later pressed upon him in *Marsh v. Martindale;*[95] "I must say that I do not quite understand it, nor should I have concurred in the judgement here given. I think that it might have been inferred that the transaction was a color for taking more than legal interest."

Two of the earliest cases cited for the proposition that since usury can only be predicated upon a loan of money, an excessive reservation of interest on a credit sale is not usurious, will repay examination. In *Floyer v. Edwards*[96] defendant bought goods on three months credit during which no interest was to be paid; if the debt was unpaid after three months it was to bear excessive interest. One report contains the dictum that where "one buys and the other sells . . . there is no pretense of any negotiation for a loan . . . nor any evidence of an agreement to forbear paying the principal sum." The actual ground upon which the decision rests, however, is disclosed by another report of the case,[97] which declares, as had many precedents from 1591 on, that "an actual borrowing of money with a penalty on forbearance is no usury, if the borrower can discharge himself by payment within the time."[98]

Spurrier v. Mayoss,[99] which contains the dictum of Lord Chancellor Wilson that

[92] Murray v. Harding, 3 Wils. 391 (1773). Also reported in 2 Black. W. 859. The case contains such dicta as "terms, not for a loan but for a purchase . . . not spoken to about lending, but about buying and selling." But as Blackstone, J., said: "I don't know an instance where the principal is *bona fide* hazarded that the contract has been held to be usurious." For a thorough analysis of such cases, see Comyn, *op. cit. supra* note 60, at 17-27, who says of the "hazard" involved, "this seems to be the proper footing upon which the decisions ought to be put."

[93] Barker v. Vansommer, 1 Bro. C. C. 150 (1582).

[94] Lutw. 271 (1702). See also Comyn, *op. cit. supra* note 60, at 30.

[95] *Supra* note 83.

[96] 1 Cowp. 112 (1774).

[97] Lofft 559 (1774).

[98] The rule is met as early as Burton's Case, 5 Co. 69a (1591): "It was in the election of the grantor to have paid the 100 pounds and to have frustrated the rent; so that the grantee (as the nature of usury is) was not assured of any recompense for the forbearance of 100 pounds. . . ." See Comyn, Usury, *op. cit. supra* note 60, at 29-31. Comyn, commenting on Floyer v. Edwards, says, "the principle of interest being optional with the debtor was referred to, and may be considered as sufficient to support the decision." *Id.* at 55.

[99] 1 Ves. Jr. 528 (1792).

"it is a contract for the purchase of houses and not for the forbearance of money" and therefore not usurious, concerns an agreement by A to purchase houses from B for 431 pounds, 200 pounds to be paid at once and the balance with interest at Michaelmas; but if not then paid, A to pay in lieu of interest a clear rent of 42 pounds, from which 5 per cent per annum on the 200 pounds was to be deducted. First, upon failure to pay, A was *not bound* to pay the 231 pounds outstanding, hence *there was no debt* which could be forborne. Upon this ground Lord Chancellor Eyre proceeded, saying that "usury is taking more than the law allows upon a loan, or as I read it, for the forbearance of a debt. Therefore, it is first necessary to see *whether there is a debt* constituted upon which there can be the forbearance. . . . There is no debt here. . . ." Second, "no conveyance having been prepared, the legal estate was still in the vendor, and therefore it was competent to the parties to consider themselves in the light of landlord and tenant"[100] until the balance was paid and the title conveyed.

Apparently *Dewar v. Span*[101] is the first case to hold that the excessive reservation of interest on a credit sale is usurious.[102] There A contracted with B for the purchase of an estate in the West Indies, and it was agreed that part of the purchase price should remain secured by the bond of B and C; that bond was afterwards cancelled and another executed in England by B and D, reserving the same interest as the former one. Counsel urged that this bond for the balance of the purchase money could not "be called usury within the general statutes of usury for they relate only to loans of money; but here [citing *Yeoman v. Barstow*] there was no loan at all." Lord Kenyon held the contract usurious, saying "if the present attempt were to succeed it would sap the foundation of the statute of usury."

It is worth noting that Ord, who wrote a treatise on Usury in 1792, takes it for granted that usury may obtain elsewhere than in loans, saying "It must not, however, be hence understood, that usury can exist only in pecuniary transactions: the taking of use for other things, as well as money, comes within the notion of usury."[103] And Comyn, who published his treatise on Usury in 1817, said: "The word 'loan' must not be too strictly construed . . . it should always be remembered that the statute lays as much stress upon the word 'forbearance' as the word 'loan,' and however some of the older cases may be construed, it now appears clear, that where *money is owing upon any kind of contract,* and forbearance is given for such

[100] COMYN, *op. cit. supra* note 60, at 29, n. 1. Spurrier v. Mayoss, 1 Ves. Jr. at 532: "Immediate possession was delivered upon the faith of the remainder of the money being paid at the time; but in the event of its not being so paid, . . . from that time the bargain for title was to be considered so far suspended, as it was to revert to the vendor [who was to be considered a lender as to the downpayment on which he would pay 5 per cent to the tenant until the latter paid the balance] and he was landlord, and was to receive the rent as such, till that took place." Apparently all three judges concur in resting the case on this ground.

[101] *Supra* note 91.

[102] That appears to be the impression of Radcliff, J., in Van Schaick v. Edwards, 2 Johns. 355, (N. Y. 1801). See also COMYN, *op. cit. supra* note 60, at 59.

[103] *Supra* note 72, at 2.

debt . . . such a forbearance [Comyn was using that term with reference to the original extension of credit][104] is as much usury as if the sum of money had been absolutely lent. . . . And it does not matter . . . whether the transaction is . . . a sale of goods; so long as the lender gain more than 5 per cent for his forbearance."[105]

Beete v. Bidgood, decided in 1821,[106] the first case to pass squarely upon the question of usury in a situation where interest was added to principal to form a lump credit price, is of special importance because upon it was reared the entire superstructure of American usury law, both as to lump credit prices and as to the express reservation of interest. The case involved the sale of an estate at a cash price of "16,000 pounds, together with the *interest* on the said sum . . . added thereto, making in the whole principal and *interest* 20,800 pounds." "The only difficulty," said the court, "has been occasioned by calling the difference between these two prices interest . . . in substance this was a contract for the sale of the estate at the price of 20,800 pounds. To constitute usury there must be a loan or forbearance. Here there was no loan or forbearance. This was a contract of sale." No cases were cited; no reference was made to the settled construction of "forbearance" which had been reiterated by *Marsh v. Martindale* just twenty years before;[107] the case of *Dewar v. Span,* wherein the express reservation of excessive interest on a sale had been held usurious, was ignored. Why did the court, oblivious to the factors just enumerated, and ignoring the clear intent to take usurious interest, refuse to hold the transaction usurious? One factor must not be overlooked, a transaction of this sort did not call for protection; the purchaser of a huge estate is under no such compulsion to buy as renders him the ready victim of oppression. Again, the judical antipathy towards usury legislation had received a great stimulus from the Benthamite arguments, which in thirty years were to result in a complete repeal of all usury laws.[108] *Laissez faire* was carrying all before it; a man has a right to set his own price; *ergo,* he may sell at one price for cash and at another for credit. Finally, the case appeared to be analogous to the *bona fide* credit price,[109] which the vendor, when asked to sell on time, fixes without reference to the exaction of interest on a set cash price. But *Beete v. Bidgood* presents a different situation; the principal was fixed, the excessive interest expressly reserved, and the corrupt intent to take excessive interest was evident from the face of the contract. The distinction between a *bona fide* credit price and the credit price formed by adding excessive interest to a fixed cash price may be fine, but the law abounds in more subtle distinctions. And, as will subsequently appear, there are reasons of administration upon which such a distinction may be based. Moreover, the distinction between the express reservation of interest on a credit sale and the lumping of such interest in a credit price is scarcely less fine, yet such an express

[104] *Supra* note 60, at 34-36.
[105] *Id.* at 59-61.
[106] *Supra* note 52.
[107] *Supra* note 83.
[108] *Supra* note 13.
[109] Assuming that the early canon law ban on such transactions had exerted no influence on common law, and that a *bona fide* credit sale was permitted at an excessive price.

reservation of interest is clearly within the usury statutes. An early American court says of a similar lump sum credit transaction, "It is a question of intention . . . the additional sum was intended as interest. . . . The 10 per cent was reserved as interest, for the time the notes had to run, and not as part of the purchase money. The statute provides that no person shall take, directly or indirectly, for any contract . . . for the payment of money, founded on any bargain, sale or loan of wares and merchandise . . . " more than the legal rate.[110]

To term the right to excessive interest the right to sell at another price for credit,[111] is merely to attach a more attractive label to the transaction. The right of the vendor to sell at any price he chooses must be distinguished, once he has fixed the price, from his right to exact excessive interest. His right to name the price at which he chooses to sell is not in issue; it is his right to exact excessive interest for permitting the debtor to retain his money that is challenged. Where the court is faced with a *bona fide* credit price alone, the doctrine of *Beete v. Bidgood* is perhaps justified on the ground that the administrative difficulties which attend an investigation of the price of goods preclude such an inquiry. No such difficulty attaches to an inquiry into the price of money, *i.e.*, interest charges. The maximum price of money has been fixed by law, whereas the price of goods is a variable which is insusceptible of ready determination. Hence, where the court is confronted with a credit price alone, there are reasons of administration, (such as the fact that, in many cases, no adequate means is at hand for ascertaining the cash price, from which the illegal interest lumped in the credit price may be computed, plus the perplexities surrounding the question of whether there was an intent to take excessive interest, or a *bona fide* sale) which may render it desirable to invoke the *Beete v. Bidgood* doctrine. These administrative difficulties vanish, however, once the vendor has himself set a cash price. The price of a new Ford car, for example, is well known; it is almost as easily ascertained as the price of money. After the cash price has been set by the vendor, a loan of money and a credit sale of a chattel are on the same plane. The problem then reduces to the question: how much can the creditor charge for the

[110] Torrey v. Grant, 10 Smedes & Mar. 89 (Miss. 1848). Although Mississippi has departed from the rule of that case in Commercial Credit Co. v. Shelton, 139 Miss. 132, 104 So. 75 (1925), the earlier case was not alluded to in briefs of counsel or in the opinion. Thompson v. Nesbit, 2 Rich. 73 (S. C. 1845), and Fisher v. Hoover, 3 Tex. Civ. App. 81, 21 S. W. 930 (1893), have also held a lump credit price, which concealed excessive interest, usurious. The writer of a Comment (1929) 39 YALE L. J. 1025, after a study of federal income tax cases wherein exemption was urged for interest paid on a current indebtedness, arrives at the conclusion that whether the interest was expressed as such, or lumped in a credit price, it was interest in both cases entitled to exemption. See note 126, *infra*.

[111] It should be remembered that the right of the early Englishman to do as he willed with his own was limited. See Adler, *Labor, Capital, and Business At Common Law* (1916) 29 HARV. L. REV. 243: "Business at common law consists in the undertaking and conduct of a community or public service for profit, and hence it is the duty of every one who takes upon himself a 'public employment,' that is, a business, 'to serve the publick as far as the employment extends.' The duty arises from the undertaking. . . . To carry on a business is to exercise a privilege. The right of a person to do with his own as he chooses need not be disputed. But the business man deals with what is not his own. He emerges from his privacy, involves the fortunes of the community with his own, and by so doing assumes an obligation to the public."

retention of his money by the debtor? Although the difference between the cash price and the credit price cannot be regarded solely as "interest,"[112] since it may include other costs (in automobile sales, for example, the cost of insurance), it remains true that the device enables the seller to conceal excessive interest. The other costs are not itemized; the buyer is compelled to buy insurance whether he will or no; thus the cost of instalment credit is enhanced.[113] The attempted rationalization in *Hogg v. Ruffner*,[114] *viz.*, that "a vendor may prefer $100 to double the sum in expectancy" is not only equally applicable to a loan, but it ignores the vital function of usury laws in regulating the extension of credit. When the intent to take excessive interest is clear and when the court need not assume the troublesome administrative burden of inquiring into the price of goods (*i.e.* where the cash price has been fixed by the seller), the contract should be held to fall within the usury statute, regardless of the form in which the transaction is cast.

AMERICAN PRECEDENTS

Although the majority view today is that no reservation of excessive interest on a credit sale is usurious,[115] the early American courts were generally of the opinion that the express reservation of such interest on a credit sale was illegal. The New York court, however, had by 1850 arrived at the contrary conclusion, and because that court exercised so great an influence on later decisions, it will be worth while to examine several of the New York decisions in some detail. (It should be noted in considering the New York cases that usury there entailed a forfeiture of the entire principal.) In 1801 the New York court divided evenly on the question in *Van Schaick v. Edwards*.[116] All of the judges concurred in deciding the case on a conflict of laws question; two of the judges, who dissented on the matter of usury, contented themselves with saying that "the notes were part of the price of land." Radcliff, J., however, said: "I have no doubt that the statute applies to existing debts as well as to immediate loans of money, and equally so whether such debts have arisen from the sale of lands, or from any other source. The statute itself speaks only of loans; but the forbearance or giving time of payment for a debt, is in substance a loan. . . . In the case of *Dewar v. Span* the forbearance of a debt arising from the sale of a real estate in consideration of interest at 6 per cent was held usurious." Kent, J., said that "Usury is taking more than the law allows for the forbearance of a debt; and whenever a debt is created, and there is an agreement to pay more than legal interest for forbearance of payment of it, such agreement is usurious."

Dry Dock Bank v. American Insurance Co.[117] is the first New York case relied on for the doctrine that there can be no usury on a bona fide sale. That case concerned the sale of 48,000 pounds in certificates for which complainants were to pay

[112] *In re* Bibbey, 9 F. (2d) 944 (1925).

[113] INDIANA DEPT. OF FINANCIAL INSTITUTIONS, *op. cit. supra* note 17, App. II, last page.

[114] *Supra* note 2.

[115] *Supra* note 3.

[116] *Supra* note 102.

[117] 3 N. Y. 344 (1850).

50,000 pounds, and as the sale was merely a disguise for a loan it was held usurious. Relying on Ord, the court defined "forbearance" to be "the giving of a further day, when the time originally limited for the return of the loan has passed." It has been previously noted that forbearance has a wider meaning which Ord did not intend to limit for the purpose of excluding credit sales from the statute. The court, contradicting its own definition of forbearance, continued: "Upon the sale of property on time, the ***purchase money becomes a debt which is forborne*** for the period limited by the credit"; confining this definition of forbearance, however, to the case of a sale used to disguise a usurious loan. No explanation was offered for so limiting the definition, and no cases were cited. Incidentally, the cases cited for the proposition that "where the contract is one of sale . . . there can be no usury whatever the price may be, or the *mode in which it may be reserved*," offer it little or no support, for *Beete v. Bidgood* is confined by its facts to a lump sum credit price, and *Van Schaick v. Edwards* was pronounced by a divided court; the persuasive, indeed the only, reasoning in that decision being to the contrary. Finally, in 1860, *Cutler v. Wright*,[118] which turns on a conflict of laws point, the interest not being excessive in Florida, where the note was payable, relies on the earlier New York cases for the statement that "to constitute usury there must be either a present loan, or a forbearance in respect to some debt previously existing."

Against this line of New York cases there were arrayed by 1860 a considerable number of precedents holding that credit sales wherein excessive interest was expressly reserved were within the statute. In 1824, *Henry v. Thompson*,[119] construing the Alabama Act of 1805, which in almost every particular reads like the English statutes, said, " . . . the old law restrained the taking of interest on any contract whatsoever at a greater rate than 6 per cent. The words used include not only the loan of money, but every article that could possibly be made the subject of a contract. . . . The words 'forbearing or giving day of payment' . . . can be applied as well to an absolute sale as to a loan." Pennsylvania followed in *Evans v. Negley*, decided in 1825,[120] and, by 1860, six other jurisdictions, including the United States Supreme Court, had joined the array.[121] It is characteristic of the use of precedents in this field[121a] that the Supreme Court decision in *Hogg v. Ruffner*,[122] which is constantly

[118] 22 N. Y. 472 (1860).

[119] *Supra* note 14.

[120] *Supra*, note 3.

[121] See *ibid.* for roster of courts and citations.

[121a] Thus, the following three Supreme Court cases are often erroneously cited to exclude sales from the operation of usury laws. In Nichols v. Fearson, 32 U. S. 103 (1833) cited for the dictum that "There can be no usury where there was no loan," defendant, the payee of a note, sold it to the plaintiff at a discount. Manifestly, one may buy a note from the payee at a discount without running afoul of the usury laws. Hansbrough v. Peck, 72 U. S. 497 (1866) concerns a sale of land with a proviso that on default vendor might declare the contract ended and consider the vendee as tenant at a rent equal to 10 per cent on the purchase money. The remark " . . . the parties agreed upon the rate of 10 per cent for the forbearance of the purchase money unpaid . . . this did not invalidate the contract," is pure dictum, since the time in which the suit might be brought had elapsed. Furthermore, the case falls within the group that where the borrower has an option to discharge himself without paying interest there is no usury. See note 98, *supra*. Finally, as in Spurrier v. Mayoss, the vendor could end the cont. act, the vendee was

cited for the dictum that, on a credit sale, even the express reservation of excessive interest is not usurious, actually supports the converse view. There the Supreme Court said "The original contract by which a debt is created may be for the purchase and sale of land, and it will nevertheless be contrary to the statute for the vendor to demand or receive more than the legal interest for the forbearance of such debt, as in the case of *Crawford v. Johnson,* where separate notes were taken for 2 per cent interest in addition to the legal interest, on the sum due for the purchase of land."

To examine the later majority cases in detail would be both tedious and repetitious. They rely on *Beete v. Bidgood,* which is confined by its facts to a lump sum credit price transaction, and on *Hogg v. Ruffner,* which expressly disavows the majority view. Two of the arguments advanced by the majority courts deserve mention. Some courts say that the excessive interest is as much a part of the consideration for the sale as is the principal; consequently it is not paid for the loan of money or forbearance of a debt.[123] Little merit is to be found in this argument, inasmuch as the excessive interest is equally a part of the consideration for a loan.[124] Or it is argued that because the reservation of interest in the form of a lump credit price is not usurious, the express reservation of interest which is in substance the same[125] is likewise valid. Though there may be some justification for courts that, on grounds of policy and because the lump sum credit transaction does not come strictly within the terms "forbearance of a debt," refuse to apply the usury statute, the extension of that doctrine to a situation that is clearly within the terms of the statute is unwarranted.

The contention that the transactions are the same in substance, when advanced in federal income tax cases in support of a claimed exemption for interest paid on an indebtedness, was rejected by the federal courts.[126] Conceding the transactions to

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not bound; the debt was contingent and there could be no forbearance of a debt. Struthers v. Drexel, 122 U. S. 487 (1887), contains a dictum that "unless there was a loan there was no usury." That case involved a sale of stock, with an option to the purchaser to resell within a year to the vendor at an advance of 7 per cent. There was of course no loan, and since no debt was created there could be no forbearance; consequently there was no ground for invoking the usury statute.

[122] *Ibid.*

[123] Tousey v. Robinson, Reger v. O'Neal, both *supra* note 3.

[124] Compton v. Compton, 5 La. Ann. 615 (1850). Nor can a divergence in treatment rest on the retention of title in a loan as contrasted with the passing of title in a sale, because, though the action of debt went for recovery in specie of the money loaned, 2 POLLOCK & MAITLAND, *op. cit. supra* note 79, at 204, it was not contemplated that the particular money was to be returned. The loan of money must not be confused with the true loan of a chattel, in which the very chattel borrowed was to be returned. Booth v. Terrell, 16 Ga. 20 (1854).

[125] Graeme v. Adams, Tousey v. Robinson, both *supra* note 3.

[126] Suits were brought under acts similar to 44 STAT. 26 (1926), 26 U. S. C. A. §2023 (b). Among the deductions from gross income which an individual or corporation is allowed to make in computing net income for the purpose of federal income tax is "all interest paid or accrued within the taxable year on indebtedness." Where a taxpayer purchases an article contracting to pay therefor in installments he may deduct the interest he pays on the indebtedness if the interest is clearly expressed as such in the contract. But, where the interest is lumped in a credit price, "interest not being provided for in the contract of sale, no part of the deferred payments will be considered as interest." Daniels Bros. Co. v. Comm'r, 7 B. T. A. 1086 (1927), *aff'd*, 28 F. (2d) 761 (C. C. A. 5th, 1928). See *Comment* (1929) 39 YALE L. J. 1025. The

be the same in substance, the common law abounds in instances of transactions similar in substance but differing in form, and expressed in dissimilar legal terms, and consequently differing entirely in legal effect.[127] If the courts occasionally disregard differences in form to give effect to substance, as, for example, where a deed absolute on its face is construed to be a mortgage,[128] it is because of equitable considerations which are not here present; equity, in fact, protects the borrower against an oppressive bargain.[129]

CONCLUSION

Usury laws originally sought to protect credit seekers against exploitation. Although the circumstances which give rise to exploitation in instalment sales may differ from those found in small loans, the necessity for protection is none the less urgent, as is made evident by the reports of legislative investigating committees recommending stringent regulation of instalment credit.[130] A distinction drawn between interest on credit sales and interest on loans will be found to rest on a slender historical and legal base. Perhaps some justification for a discrimination may be found in the administrative difficulties which accompany an inquiry into chattel prices. Where this problem is non-existent, the reason for the discrimination disappears. Hence, to return to the situations set forth at the beginning of this article, in transaction 2 where the credit price alone is known and an inquiry into the original cash price would be burdensome, the courts properly decline to enter into such an investigation. But, where the cash price is known and it is obvious that excessive interest is reserved for the extension of credit, the transaction should be held usurious, though in the guise of a lump credit price. Where the excessive interest is clearly reserved on a credit sale, as in transaction 3, the minority doctrine (that the express reservation of excessive interest on a sale is usurious) is logically inescapable.

There is no more reason for the courts to disregard the statutory maximum in the

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intimation of the cases is that the courts will not enter into the difficult inquiry as to what was the original price on which interest was computed. The discrimination is pragmatic, not logical.

[127] For example, a chattel mortgage is an absolute sale with a reservation of a lien to secure the purchase money; a conditional sale is a mere agreement to sell upon a condition to be performed. Harkness v. Russell, 118 U. S. 663 (1886). There is no right of redemption on a conditional sale, Pfeiffer v. Norman, 22 N. D. 168, 133 N. W. 97 (1911); on a chattel mortgage the vendee may redeem. *In re* B. & M. Motors, 277 Fed. 808 (1922). Another instance is the distinction between estates on special limitation and those on condition. A devise to X, *as long* as he remains in the manor, creates an estate on special limitation, and if the event happens no reëntry is required; the estate automatically revests in the grantor. First Universalist Society v. Boland, 155 Mass. 171, 29 N. E. 524 (1892). A devise to X, *on condition* that he remain in the manor, creates an estate on condition; and the grantor must reënter to revest the estate. Petition of Copps etc. Church, 120 Ohio St. 309, 166 N. E. 218 (1929).

[128] Shattuck v. Bascom, 105 N. Y. 39, 12 N. E. 283 (1887).

[129] Barrett v. Hartley, L. R. 2 Eq. 789, 795 (1886); James v. Kerr, L. R. 40 Ch. D. 449 (1889).

[130] INDIANA DEPT. OF FINANCIAL INSTITUTIONS, *op. cit. supra* note 17. The Wisconsin Legislative Interim Committee has been engaged in investigating consumer credits for more than a year, and is shortly to make its recommendations. The Clerk of the Wisconsin Senate, Mr. L. E. Packard, informed the writer that the Committee had uncovered many abuses.

case of a credit sale than in the field of small loans. Though the courts realized that the cost of making small loans exceeded the statutory maximum, they left the problem of establishing a more adequate rate to the legislature. No better ground for judicial legislation exists in the case of a credit sale. In fact, the solution worked out by the majority of courts in seeking to facilitate credit sales has, in many cases, been as pernicious, from the viewpoint of one needing credit, as was the once complete repeal in England of all restrictions on loans. The problem of credit sales must be solved as was the problem of small loans—by the legislature; but what form the legislative solution should take the writer does not attempt to specify. No contradiction is involved in urging legislative intervention and at the same time invoking the aid of the courts because: (1) it is in the interest of legal symmetry and of avoiding legal obscurantism that the courts should make no distinction between interest on sales and that on loans; (2) more important is the fact that this pressure exerted by the courts through the medium of existing usury laws will hasten legislation.[131] It may result in temporary inconvenience; the commercial interests involved are large;[132] but the powerful, well-organized, merchant group can obtain remedial legislation in short order. When that legislation is drafted, enough aroused consumer opinion exists to compel the interpolation of some necessary consumer safeguards.

In many states the courts are still in a position to lend their aid to the instalment debtor. In the minority states, at least those transactions in which the interest is expressed as such can be controlled by the courts. In a considerable number of states no cases involving usurious interest on a sale have been passed upon. While the weight of authority may be persuasive in such states, each state is free to construe its own usury statute in the light both of present social needs and of the common law signification of the terms employed in the statute. There are also a number of states where the question is regarded as closed, but where a vigorous attempt to bring credit sales within the operation of the statute might perhaps not be unproductive. In Illinois, for example, the question has yet to be passed upon by the court of last

[131] It will not be the first time that the courts have thus hastened the pace of legislation. Professor Edwin F. Albertsworth of the Northwestern University School of Law has made a careful study of the use of this device by the courts, and he has been kind enough to give the writer access to materials to be published in the May, 1935, issue of the *Georgetown Law Journal*, under the title "Advisory Opinions by Judicial Dicta." He is of the opinion that the Supreme Court, through its refusal to sustain State Compensation Laws in the field of maritime injuries and deaths, compelled Congress to enact a Federal Compensation Law to remedy these evils. He is also of the opinion that the Supreme Court is construing the Federal Employer's Liability Act in such fashion as to force a Federal Compensation Act in rail callings.

[132] The avoidance of usurious credit contracts will in many states entail no more than the forfeiture of the interest. See Tables in RYAN, USURY AND USURY LAWS (1925) for penalties on forfeiture. In states where the effect may be more serious, the writer submits that evil results may be avoided by giving only prospective operation to the decisions, *i.e.* by making the decision applicable only to contracts made thereafter. See Kocourek & Koven, *Renovation of the Common Law Through Stare Decisis*, 29 ILL. L. REV., April, 1935; Address by Mr. Justice Cardozo (1932) 55 N. Y. STATE BAR ASSN. REP. 263, 293; Sunburst Oil & Refining Co. v. Great Northern Ry. Co., 91 Mont. 216, 7 P. (2d) 927 (1931).

resort; an intermediate court has relied upon older Illinois cases which lend no support to the proposition that there can be no usury predicated upon a sale.[133]

At no time has the writer lost sight of the fact that the attitude of present-day courts to the problem of instalment sales has been guided by expediency, by the realization that the statutory maximum inadequately provided for the cost of extending consumer credit. On the other hand, this policy has left the consumer group, to whom such credit is vitally important, utterly defenseless. Only after a balancing of interests can a policy be formulated. The writer believes that the vast, inarticulate body of consumers stands more in need of protection than the readily mobilized, vocal, merchant group. The plight of the former will not inspire immediate legislation, whereas the merchant group, if compelled by judicial application of existing usury laws to act, is in a position to exert pressure on legislative assemblies and to obtain almost immediate relief.

[133] Primley v. Shirk, 60 Ill. App. 312 (1895), is cited for the dictum that "on a sale . . . there can be no usury charged simply because the price is fixed at one sum if paid at one time, and at another sum if paid at another." There the vendor of land had agreed to hold $15,000 at the disposal of the vendee who was to acquire therewith title to a designated alley. That sum was added to the credit price, to be credited thereon if not advanced. It was never demanded by the vendee, who at the time of suit disputed the interest charged on the $15,000. The Supreme Court, affirming in 163 Ill. 389, 45 N. E. 247 (1896), disregarded the ground chosen by the Appellate Court and held that since the vendor had kept the $15,000 at the disposal of the vendee throughout the life of the contract, thereby being deprived of the use of his money, the vendor was entitled to interest on that sum.

In Clemens v. Crane, 234 Ill. 215, 84 N. E. 884 (1908), cited for the proposition that to constitute usury: "1. there must be a loan or a forbearance; 2. the loan must be of money," the claimant had advanced money to decedent to *invest* in his business, under a partnership agreement which guaranteed to claimant a minimum of 15 per cent on her investment. The court took great pains to establish the intent to invest in a partnership, and held that the "transaction could not be converted into a usurious loan."

Manufacturers Finance Trust v. Stone, 251 Ill. App. 414 (1929), passes on a case where interest was lumped in a credit price. The court cites the Appellate decision in Primley v. Shirk, *supra*, for the proposition that "appellee was a *bona fide* purchaser of property, not a borrower of money," and cites Clemens v. Crane to the effect that to "constitute usury . . . there must be a loan or forbearance . . . of money." The Clemens case says "there must be a loan or *forbearance*; the *loan* must be of money"; and in neither of the cases cited was the court called upon to distinguish between a credit sale and a loan.

It is worth noting that the Stone case is confined by the facts to a lump sum credit price. Furthermore, the court said, "A similar state of facts . . . was considered . . . in . . . General Motors Acceptance Corp. v. Weinrich, 218 Mo. App. 68, 262 S. W. 425 (1924) and held not to violate the Usury Statute of Missouri, which is *similar to our own statute*." The Weinrich case says "Of course, the fact that a note is given for the purchase price of an article will not prevent the note from being usurious *if the note calls for more interest than the law allows*."

COMMENTARY ON "USURY IN INSTALMENT SALES"*

Stanley B. Ecker†

Extensive comment upon the subject matter of Mr. Berger's thesis, due to the short period of time afforded for its review, has unfortunately been rendered impossible. This commentary will therefore be confined to the major points developed by Mr. Berger, and to a treatment directed primarily at the practical and factual, as distinguished from the purely legalistic, aspects of his treatise.

The Thesis Summarized: As the writer of this commentary understands it, Mr. Berger's thesis, briefly summarized, is as follows:

(1) Originally, usury laws were adopted to protect against exploitation, whether of borrower or buyer.

(2) In the Nineteenth Century, however, "the canonical notion that an excessive credit price was usurious was swept away by the rising tide of commercialism"[1] and since that time the courts have excepted credit-sales from the operation of usury statutes—unanimously where a "lump credit price" has been fixed by the seller, and by a majority of courts where the seller has expressly reserved excessive interest on the cash price.

(3) Where the cash price is known and excessive interest is clearly reserved on a credit-sale, the courts should apply the usury statutes—following the existing minority rule—and

(4) Where the cash price is known "and it is obvious that excessive interest is reserved for the extension of credit, the transaction should be held usurious, though in the guise of a lump credit price."[2]

(5) If, by reason of decisional precedent, the courts cannot accomplish this result, or when this result has been achieved, the legislatures should then intervene to enact

* Editor's Note: Galley proof of the preceding article, *Usury in Instalment Sales*, by Mr. Raoul Berger, was submitted to Mr. Ecker with a request for his comments. Unfortunately, the circumstances of publication were such as to afford Mr. Ecker only a limited period of time for review and comment, and Mr. Ecker's comment could not in turn be submitted to Mr. Berger.

Italics throughout are the writer's.

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[1] See sentence following footnote 52 of Mr. Berger's article, *Usury in Instalment Sales, supra* p. 148, at p. 156.

[2] See "Conclusion" of Mr. Berger's article, pp. 170-172.

legislation for the "protection" of the consumer because (a) the distinction between credit sales and loans rests "on a slender historical and legal base,"[3] (b) the "solution worked out by the majority of courts in seeking to facilitate credit sales has in many instances been as pernicious, from the viewpoint of one needing credit, as was the once complete repeal in England of all restrictions on loans";[4] (c) the need for protecting the instalment buyer against "exploitation" is as urgent as it is in the case of the necessitous borrower.

THE HISTORICAL BACKGROUND AND LEGAL PRECEDENTS: We have no quarrel with Mr. Berger on the development of the historical background which he has traced back to Biblical days, nor with his exposition of the English and American precedents relating to usury laws. Although not in entire agreement with all of Mr. Berger's statutory and decisional analyses, we are quite willing for the purpose of this commentary to accept their validity. We are emphatically unwilling, however, to concede the validity of the argument and conclusions which Mr. Berger has proceeded to erect on the foundation of his historical development and on the premise of his decisional and "social and economic" analyses.

THE SIGNIFICANCE OF THE JUDICIAL PRECEDENTS: The judicial exclusion of credit sales from the operation of usury laws—which Mr. Berger characterizes as "one of the phenomena resulting from the bias of courts against usury legislation"[5]—had its initiation in the Common Law in the case of *Beete v. Bidgood*[6] (decided in 1821), according to Mr. Berger, who, commenting on this decision, says: "Possibly the canonical notion that an excessive credit price was usurious was swept away by the rising tide of commercialism."[7] If the word "possibly" had been omitted from this comment; if the significance of the statement, *minus* the "possibly," had been fully realized and then applied by the author to the *facts* of instalment selling and instalment-sales financing as they exist today, it is this commentator's belief that the tone and substance of Mr. Berger's treatise would have been completely changed—and the conscientious reader of this journal spared the labor of scanning this commentary.

The fact of the matter is that the court in the case of *Beete v. Bidgood was* influenced—and properly so—by the "rising tide of commercialism" to cast aside the "canonical notion" that a bona fide sale on terms of a deferred payment of the sales price is in the same category as a loan; and that the court was cognizant of the necessity, in a commercial as distinguished from a "canonical" world, of freeing commercial transactions which depend on the extension of credit from the dangers of forfeiture and penalty. And it is significant to note, as Mr. Berger points out, that the courts, both English and American, have, since *Beete v. Bidgood,* with complete unanimity followed its precedent. Whether or not the wisdom of the judicial adherence to the doctrine of *Beete v. Bidgood* has been vindicated—viewed from the

[3] *Ibid.* [4] *Ibid.*
[5] See sentence following footnote 8 of Mr. Berger's article, p. 149.
[6] Footnotes 52 and 106 of Mr. Berger's article, pp. 156, 165.
[7] See note 1, *supra.*

social and economic standpoint, is a question to be answered later in this commentary.

ANALYSIS OF THE INSTALMENT SALE: At the portals of his treatise Mr. Berger has posed, for the reader's inspection, a hypothetical Mr. "A," and three hypothetical transactions upon which Mr. "A" is thereupon embarked: (1) In Transaction One Mr. "A" borrows money and pays cash for some furniture. (2) In Transaction Two Mr. "A" buys the furniture on what Mr. Berger terms "the instalment plan" at a credit price "determined by adding the interest in a lump sum to the cash price." (3) In Transaction Three Mr. "A" also buys "on the instalment plan," obligating himself, however, "to pay the seller the cash price, at an interest rate expressed as such."

Transaction One is of course a loan. Transaction Two Mr. Berger would treat as a loan. And Transaction Three he would, via the route of judicial decision or legislative act, treat in the same way as Two. And if the "interest," whether separately reserved as in Transaction Three, or "lumped" in the credit price, as in Transaction Two, exceeds the legal rate of interest for a loan, Mr. Berger would brand these sales with the stamp of usury, and subject to the forfeiture and penalties imposed by the usury statutes, the vendor's rights against the buyer.

Let us stop for a moment to analyze Mr. Berger's hypothetical Transactions Two and Three, with a view to ascertaining which, if either, represents the modern credit sale. The typical credit sale of today is a sale on the instalment plan and it is of course on the instalment sale that Mr. Berger has centered his entire thesis. It is common knowledge that,—whether or not he intends to dispose of the paper created in connection with the instalment sale to a separate financing corporation,—the instalment seller does not require the buyer "to obligate himself to pay the seller the cash price, at an interest rate expressed as such."[8] Accordingly, we may dismiss from our consideration as having only academic interest the hypothetical transaction numbered "Three,"—and proceed to Transaction Two.

Transaction Two, we will remember, is the case stated by Mr. Berger as a sale "on the instalment plan" at a credit price[9] "determined by adding interest in a lump sum to the cash price." We start off then with the cash price, which is presumably a known factor. We then add "the interest in a lump sum,"—and that, Mr. Berger would evidently have us believe, is a typical instalment sale. Of course it isn't—for the simple reason that the amount which is added by the instalment seller to the cash price isn't "interest" at all.

In determining the cash selling price of any commodity every merchant takes into account the cost to him of the commodity and the cost to him of consummating the sale,—which means all costs incurred by him up to the time when he receives payment from the buyer, and even beyond that time, in cases where the seller may be called upon to "service" the commodity which he has sold. If services must be

[8] See first paragraph of Mr. Berger's article, p. 148. [9] *Ibid.*

rendered and expense incurred, the cost of such services and the amount of such expenses are added by the merchant in determining the price at which he will sell. And if the sale is to be made on a "charge account" basis, or on the basis of a sale subject to a discount if paid within a certain period of time, the vendor will also take into account, in determining his selling price, the cost to him involved in deferring receipt of payment for the commodity he has sold. To the writer's knowledge, no one has ever advanced the proposition that any one of these elements which commonly go to make up the selling price of goods should be labeled "interest"; and no reasonable person would. Yet, where the sale-on-credit is payable in instalments, by some mysterious evolution these elements become transformed in Mr. Berger's mind into "interest," with the result that the instalment seller is set apart from his more fortunate brethren, the vendor-for-cash and the vendor on the charge account or "discount" basis, and forced to justify the price at which he has sold "on credit" by application of the measuring stick of a usury statute!

The exposition of the "Historical Background" of usury laws contained in Mr. Berger's treatise is of more than academic interest when examined in connection with the foregoing discussion. Reduced to a few words the historical essence amounts to this: "Interest," from Biblical days to date, has always been a term employed to describe the measuring stick for monetary compensation for forbearance; and where parties to an agreement express, or the facts of a transaction evidence, a clear intention that the compensation to be paid by the one to the other is to be a compensation reserved *solely* as consideration *for forbearance,* there is validity to the argument that the "interest" measuring stick should be applied and that the transaction should accordingly fall within the purview of laws relating to "interest." But where no such intention is expressed and where, as in the case of a bona fide credit sale, the compensation to be paid is not in consideration of forbearance alone, but of the costs and expenses which must necessarily be incurred by the seller before consummation of the sale and payment to him of the purchase price, there can be no validity to any argument which would place the instalment seller in any different position, economic or legal, than the seller for cash.

What then are the factual elements inherent in the modern instalment sale? Is there any essential difference between the elements taken into account by the seller in determining the time-selling price and the factors, mentioned above, which other sellers take into account in fixing the price which they are willing to accept for their wares? The seller "on credit," as in the case of other sellers, knows that both prior and subsequent to delivery of the goods to the buyer, he will have to incur various items of expense, before receipt of the full purchase price and final consummation of the transaction; and, like the seller for cash, he must take account of these items in determining his selling-price. The expense of investigating the credit of the prospective purchaser must be incurred before the sale is approved; if the credit is acceptable and the sale made, the account must be set up on the books of the seller

and thereafter each week or month, depending upon the terms of payment, the purchaser must be notified of the maturity of his instalment and collection effected of the instalments as they mature until full payment of the purchase price has been made. Should the buyer be "slow" in making his payments or should default occur, the expense of collection is of course increased and may include the fees of attorneys and the costs of court proceedings. Frequently, and, in the case of motor vehicles, customarily, insurance[10] must be purchased to protect the time-seller's interest in the chattel, which of course constitutes another element of expense which must be taken into account by the time-seller in determining the time-selling price. This item of "overhead" as a matter of fact is also one which is incurred by the cash-seller, but of course in the case of a cash sale the coverage and therefore the expense of the insurance is limited to the period prior to delivery of the goods to the buyer.

As in the case of the charge-account sale and the sale at a "discount" (which is deductible from the purchase price if the account is paid within a stipulated period), the merchant who sells on the instalment plan must also take into consideration the fact that while any balance is outstanding and unpaid on the purchase price, he is deprived, pro tanto, of the use of the funds which, had full payment been made by the buyer in cash on delivery, he would have been able to utilize immediately in his business. This factor is of course an important one from the viewpoint of the instalment seller, as it is in the case of other sellers who do not receive payment in cash of the full purchase price on delivery of the goods. It is an element, as is the risk of credit losses, which must necessarily be considered in the determination of the selling price but it is *only one* of the various elements, mentioned above, which are determinative of the amount at which the time-seller may be willing to dispose of his goods. On Mr. Berger's premise and the clear implication of his argument, this element, which he terms and would treat as "interest," is *the only one* which enters into the computation of the credit price. This premise being erroneous, Mr. Berger's entire argument falls, and with it, the conclusions which he has erected thereon.

It might be contended by Mr. Berger, in support of the analogy which he seeks to draw between an instalment sale and a loan of money, that the elements adverted to above which the seller takes into account in fixing the credit price of his merchandise are the same and are given the same consideration as those which the lender of money takes into account in determining the interest charge for the so-called "small loan." The distinction, from an economic point of view, between a credit sale and a loan is considered later in this Commentary; two distinguishing factors might, however, be mentioned at this point. The first is inherent in the fact that the seller on time is motivated and restrained, in determining the charge to be made for the time-sale, by commercial and competitive considerations, which do not influence to the same extent, if they influence at all, the lender of money. The other,

[10] See Adelson, *The Mechanics of the Instalment Credit Sale*, *infra*, p. 218, particularly the section entitled "Insecurity and Insurance Provisions," p. 231, and statements preceding and following the reference to footnote 18 in his article, p. 222.

a material factor in fixing the time-price, relates to the dollar-amount to be charged the buyer for the use of the goods sold, and involves a determination of the variable of depreciation and the effect of the buyer's use of the goods on the resale value in the event of their return to the seller. This factor is of course non-existent in the case of the small loan which is made on the strength of one or more endorsements, and, in the case of other small loans, which are for the most part secured by the household goods of the borrower, is of relatively little importance, because the value of the collateral in the latter type of loan lies in what might be termed the "deprivation value" inherent in the threat of foreclosure rather than in the value of resale, the criterion of the vast majority of time-sales.

The factual elements in the instalment sale, briefly outlined above, are today so well known that it would be surplusage to cite authorities in proof of their existence. That the courts, cognizant of these elements, have uniformly and unanimously refused to deprive the instalment seller of the right to determine, as does the seller for cash, the price at which he may sell, is admitted by Mr. Berger[11] who has referred to some of the cases. Express support for this analysis is to be found in judicial opinions.[12]

THE STATUS AND FUNCTION OF THE FINANCE COMPANY IN INSTALMENT SELLING: The legal status of the finance company as the assignee of the instalment contract, and the general method of operations of sales finance companies are, I understand, to be made the subject of complete exposition elsewhere in this issue. Briefly, the part played by the finance company in financing consumption is as follows:[13] (1) The finance company makes the credit investigation of the purchaser; (2) if the transaction is acceptable to the finance company, the instalment contract is purchased from the seller of the goods; (3) after the contract has been purchased the finance company, as assignee, performs the collection services which otherwise would have to be performed by the seller. All of the cost and expense, (including the cost of insurance-coverage of the commodity), and all of the risk, except to the extent of the protection afforded by the recourse (which is usually a limited recourse) against the seller, which

[11] See first paragraph of Mr. Berger's article.

[12] See Comm. Credit Co. v. Tarwater, 215 Ala. 123, 110 So. 39 (1926): "The dealer had the perfect legal right to dispose of the property on such terms as agreed upon, one price for cash and another price if sold on credit. . . . there are elements of risk, trouble, and expense incident to such transactions, which are to be taken into account, but of whatever items it may be composed, if in fact the sum agreed upon represents in good faith the credit price of the car as understood by the parties, the transaction is free from any taint of usury." See also *In re* Bibbey, 9 F. (2d) 944 (D. Minn.): "There is no question but what the seller may name a greater price when he sells upon time than when he sells for cash, and that is not an unusual practice and custom in merchandising. Of course, in calculating the amount of addition to the cash price, where the goods were sold upon time, what would be a proper interest upon the investment is taken into consideration; the chances of loss and failure to pay, and the insurance necessary to cover the transaction, and the overhead expense for carrying on a business of that kind, all find a place in ascertaining how a merchant may profitably sell upon time and the price to be charged; but this does not make a usurious contract."

[13] Mr. Adelson's article, *The Mechanics of the Instalment Credit Sale*, *infra*, at p. 219, presents an excellent exposition on this subject. See also Cavers, *The Consumer's Stake in the Finance Company Code Controversy*, *infra*, p. 200, particularly the introductory paragraphs and the section entitled "The Organization of the Industry," p. 201.

the latter takes into account in determining the time-price, are assumed by the finance company. Based on its knowledge of the cost and expense and the risk elements which enter into the instalment sale, and its specialized experience in the field of consumer credit, the sales finance company establishes the price at which it will acquire paper from the instalment-seller. This is done in the field of automobile sales financing through the medium of what are commonly termed "rate charts" furnished by the finance company to the seller so that he may know, before consummating the sale, the price at which he will be able to dispose of the instalment contract arising therefrom. Ordinarily, the instalment-seller, in determining the price at which he will sell "on credit,"—and this is especially true in the case of sales of automobiles,—will add to the cash price the dollar and cent amount of the differential shown in the finance company's rate chart. If this is done and the sale of the paper to the finance company is completed, the seller will have received in cash the amount which he would have received had the buyer purchased for cash rather than "on time." It should be emphasized at this point that until the instalment contract has been purchased the finance company has no contact which the instalment buyer, except as might be made necessary by reason of the credit-investigation service performed by the finance company, and that except to the extent that the seller may be influenced by the price which the finance company has indicated it will pay for the paper, the finance company plays no direct part in establishing the price at which the time sale may be made.

The function of the sales finance company and the importance of its role in our present day industrial system cannot be understood unless cognizance is taken of the close relationship which exists between the manufacturer and distributor of commodities ordinarily sold "on credit" and the financing corporations. This relationship, as is true in the case of at least one of the so-called national finance companies, may be cemented by capital stock ownership; it may exist by virtue of contractual arrangements pursuant to which the services of the financing company may be recommended by the manufacturer; or it may exist without stock ownership and without any contractual arrangements between the manufacturer and the financing corporation.

The major aims of the manufacturer in these days of mass production are (1) to maintain as low as possible the cost of production and (2) to maintain as low as possible the cost to the consumer. Increased volume of sales of course aids in the accomplishment of these aims, and instalment selling has proved to be an effective means of increasing sales volume.[14] However, unless the manufacturer and the merchant are able to meet the sharp competition prevalent in modern merchandising by maintaining a low cost to the consumer, increased volume and enhanced profit to the manufacturer and to the merchant will not be obtainable. It is a fact, therefore, that the manufacturer and the merchant are ever on the alert to maintain low

[14] See quotation from the Report to the Wisconsin Legislature of the State Banking Committee and Interim Advisory Legislative Committee, *infra*, p. 181.

financing charges, and because of the benefits which are derived from a satisfactory relationship with manufacturers and merchants, the sales finance company has in the past always been, and it may with certainty be expected will in the future continue to be, actively responsive to factory and distributor pressure to maintain as low as possible the level of financing charges. It is apparent, then, that the operations of sales finance companies are substantially affected by the manufacturing and merchandising problems of the seller of goods, and that Mr. Berger's argument, which links the instalment sale with a loan on the ground that the "motives" actuating the activities of separate financing corporations are "not distinguishable from those of a lender,"[15] is built upon a false premise of fact and is therefore untenable.

At one point in the course of his treatise Mr. Berger seeks to create the impression[16] that the cost to the consumer of instalment credit has increased and that increased volume of instalment-sales and instalment-sales financing have not brought about any decrease in the consumer-cost. In refutation of this, the following statistics, taken from published rate charts of the company with which the writer is associated, are significant: (It is reasonable to assume, due to the highly competitive conditions existing in the field of consumer-financing, that these statistics are typical of the general trend of sales-financing rates.) The volume of business of this company, in the year 1932, was substantially less than the volume of business for the comparable period in the current year. However, the consumer-cost of financing the purchase of three standard makes of motor vehicles (after adjustment of the 1932 finance rates so as to reflect the inclusion of collision-insurance coverage equivalent to that included in the 1935 finance rates) shows a *decrease* in the average of 19.02 per cent in one of the territories in which the operations of this company are conducted, 16.47 per cent in another territory and 8.62 in a third territorial division. The foregoing statistics are based on financing rates applicable to instalment purchases in three widely divergent territories in the United States.

In this connection, Mr. Berger seems to contend that the profits earned by "separate financing corporations" have been inordinate.[17] It is correct that the operations of the so-called national finance companies have been profitable over a period of years. It is denied however that the profits earned by these companies, on a comparative basis with the profits of representative groups of industrial, utility, and railroad corporations, have been excessive. From the standpoint of the consumer the measuring-stick to be applied to the profits of a finance company is the profit-return to the finance company based on the amount of funds, whether derived from capital or other sources, placed at the disposal of the consumer through the mechanics of financing his instalment paper. The proper test, therefore, must necessarily be a comparison of the amount earned by finance companies in relation to the total assets from which these earnings are derived, with the amount earned by other

[15] See the last sentence but one preceding Mr. Berger's section entitled "Historical Background, p. 153.
[16] See statement in Mr. Berger's article which precedes his footnote 35, p. 154.
[17] *Ibid.*

businesses in relation to the total assets employed by them. Standard Trade and Securities—Bulletin of July 13, 1934, publishes the earnings and balance sheets of 418 industrial corporations representing the leading organizations in the country; also, of 22 leading public utilities and 25 large railroads. The industrial group averaged during the years 1927-33 inclusive 5.11 per cent of net income to their total assets; the public utilities for the same period averaged 3.28 per cent and the railroads for the same period averaged 4.35 per cent. We find, however, from an analysis of data contained in Moody's Manual of Investments that the three leading finance companies which handle a majority of the financing in the consumer credit field averaged only 3.25 per cent of net income as compared with the assets employed by them during this same period.

THE SOCIAL AND ECONOMIC FACTORS: The failure of Mr. Berger to appreciate the close relationship between the sales finance company and the manufacturer and distributor of consumer-goods, and the influence of this relationship upon the "motives" of separate financing corporations, accounts in large measure for the recommendations outlined in the "Conclusions" to his article (summarized as Item 5, in the opening paragraph of this Commentary). It is also apparent, however, that Mr. Berger's views on what he terms the "social and economic factors" inherent in the field of consumer credit and consumer credit financing have unfortunately been colored by other factual misapprehensions chief among which are the following:

(1) " . . . Pernicious from the viewpoint of one needing credit . . .," according to Mr. Berger, has been the result "in many cases" of the refusal of courts to bring credit sales within the purview of usury statutes.[18] That the result has been the opposite of "pernicious" is pointed out in the Preface to the Report of the State Banking Commission and Interim Advisory Legislative Committee recently submitted to the Wisconsin Legislature.[19] The following language taken from the Report is worthy of quotation:

"Therefore, it should be borne in mind in considering the reasonableness of consumer credit charges that the production, distribution and sale of articles in installments was only made possible for the mass of consumers because of adequate mass financing. This mass financing has brought within reach of the average individual a wealth of articles which were never thought of in previous years, has raised the standard of living of the common people, and has reduced the price of thousands of articles until they are within the reach of the average individual. Prior to the evolution of mass finance, an ordinary automobile cost approximately three times as much as it does today and this holds true with many other articles which are now considered in the realm of necessities for the average family.

"The automobile finance and loan companies are a recent development, practically within the past thirty years. As before stated, due to this rapid growth it is only natural that abuses have crept in. The Committee, however, has been agreeably surprised to find that a large portion of this business is handled upon a rather high plane, and with the

[18] See note 2, *supra*.

[19] This is the Report to which Mr. Berger refers in his footnote 130, p. 170.

elimination of certain abuses as herein pointed out, the Committee feels certain the consumer will not have much cause for complaint.

"Consumer credit is a highly specialized business, which requires special organization and highly specialized methods of operation. This has been generally recognized, particularly by commercial banking institutions who consider consumer credit companies among their best risks. The finance companies of the United States are today probably the largest borrowers from the commercial banking system, second only to investments made in United States Government bonds.

"It is conceded that the automobile industry has come through a great depression employing thousands of people at substantial wages and without increasing the price of their product. This industry might well have been prostrated during the depression in the same manner as hundreds of other industries, were it not for the fact that dealers and purchasers of automobiles have been at all times adequately financed. Had consumer credit in this line not been available, the automobile and other merchandise sales would have been paralyzed, additional thousands would have been thrown out of work and the prices of merchandise would have materially increased to a point out of reach of the average consumer."

(2) "Glaring credit abuses"—according to Mr. Berger—abound in the field of consumer credit. As authority for his statement Mr. Berger refers to the report of the Indiana Department of Financial Institutions which in turn quotes from the report of an investigation by the Pollak Foundation for Economic Research. Examination of this report shows isolated examples of high finance charges for the most part in connection with the sale of commodities having no standardized cash price. Although Mr. Berger admits that "the standard high-grade finance companies' rates on long term contracts are considerably lower,"[20] he does not point out that most of the dollar volume of instalment-sales financing is handled by these companies.[21] That rate "abuses" affect only a small percentage of the total volume of consumer credit has been recognized in the Report of the Wisconsin Banking Commission and Interim Advisory Legislative Committee, which emphasizes the fact[22] that in the State of Wisconsin about 15 per cent of those engaged in the automobile finance business and the selling of automobiles on time payments are responsible for 95 per cent of the abuses to which reference is made in the Report;[23] it is also significant that the Report of the Wisconsin Committee, by its own terms was "not directed against the eighty-five per cent of individuals who are carrying on said lines of business in a legitimate and ethical manner, *and who handle at least ninety per cent of the total volume of business.*" It is reasonable to assume that where abuses exist in the field of consumer financing—in states other than Wisconsin,—the percentage of dollar-amount of transactions affected is similarly insignificant.

[20] See Mr. Berger's footnote 17, p. 150.

[21] On this point, see Cavers, *The Consumer's Stake in the Finance Company Code Controversy, infra,* at p. 201.

[22] At p. 4.

[23] The Committee qualified its statement by excepting practices with respect to "reserves, rebates and pack abuses and concealment of rates." A discussion of these subjects appears in Cavers, *The Consumer's Stake in the Finance Company Code Controversy, supra* note 19.

(3) At various points in his treatise[24] Mr. Berger refers to concealment and "obscurity" of actual credit costs, particularly through "such devices as the lump sum credit price." All of this indicates Mr. Berger's belief to be that the instalment buyer is generally deceived as to the cost to him of buying "on credit" with the result that his "bargaining position" is thereby "impaired."

Now, what are the facts? With the exception of a few such articles as jewelry, furniture and clothing, the instalment sales of which amount only to a small fraction of the total dollar-amount of credit sales, practically every commodity which is generally sold on credit has a standard or at least a readily ascertainable cash selling-price and is sold in a highly competitive retail market. That being so, the opportunity for concealment and "deception" in the case of an instalment sale is no greater than in the case of a cash sale. The prospective instalment buyer can "shop" for the proper time price, as he can for the proper cash price, and his "bargaining position" is accordingly left entirely unimpaired. Furthermore,—and this is particularly true in the case of automobiles, refrigerators and oil burners—the contract forms used by the sellers frequently show on their face, in itemized form, the cash price together with the dollar amount of the financing charge. In this connection it is interesting to note the program initiated by one of the national sales finance companies to instruct the instalment buyer, through an extensive advertising campaign, as to the various elements entering into the time price of an automobile. These advertisements point out how the time buyer may check and compare costs in time payment plans, by enumerating in chart-form, the items of down payment and total monthly payments, from the sum-total of which the cash price, also enumerated, is deducted to show the resulting cost of financing and insurance.

Mr. Berger refers[25] in his article to the recommendation of the Consumers Advisory Board that the statement of the finance charge be shown in the instalment contract both as a money charge and "as a rate per month on the unpaid balance of the contract." Mr. Berger comments on the "indignant protest by the finance companies" to this suggestion—and a moment's consideration of the question shows the justification for the protest. The requirement that the instalment seller state the finance charge in terms of interest, to start with, induces a misrepresentation of the facts to the buyer, because it is based on the false premise that the finance charges represent "interest." Furthermore, the statement that the finance charge is equivalent to interest at a certain per cent per month on descending unpaid balances owing on the contract of purchase would mean little or nothing to the man who buys on time. The ability of the instalment buyer to pay for the commodity which he has purchased "on credit" depends upon a careful budgeting of his income and of his required expenditures, and it is apparent that the information conveyed by such a statement would be of no aid to the buyer in determining the make-up of his budget. If you tell a prospective

[24] See particularly Mr. Berger's discussion in the third paragraph of his section on "Social and Economic Factors," p. 151.

[25] See Mr. Berger's footnote 23, p. 152.

time buyer that the cost to him of buying an automobile on a twelve monthly payment plan rather than for cash would amount to $60 more than the cash price, he will know that $5 per month more will have to be available than if he had accumulated his savings and then purchased for cash. If, in addition, you tell this buyer that the $60 is equivalent to a stated per cent per month on the descending unpaid balance of the purchase price, you add nothing useful to his fund of information—and will probably have accomplished no more than to confuse him. Further—to make this requirement effective would unquestionably result in increasing the financing cost to the consumer—because of the mechanical burden and consequent expense factor imposed upon the seller of computing in the case of each transaction, the cost of the credit, transposed mathematically into terms of "interest" on each monthly unpaid balance of the purchase price. The recommendation of the Consumers Advisory Board that the statement of the finance charge be shown in terms of interest as a rate per month on descending unpaid balances was incorporated in several bills introduced in various state legislatures during the current legislative sessions. It is significant that without exception the legislative bodies in these states rejected the recommendation.

(4) At various points in his treatise Mr. Berger takes the position that there is no real distinction, from an economic point of view, between a credit sale and a loan[26] and that the purchaser on credit is for all practical purposes in the same category as the necessitous borrower, for whose protection the usury statutes were enacted. In the case of this type of borrower it is his "necessities" which require the procuring of a loan of money. His credit is low, or non-existent; his needs are great; he is not a free agent. He must be protected from unscrupulous and exacting lenders whose sole motive is to capitalize on his needy situation. In the case of the purchaser of property on credit the situation is entirely different. He is moved by desire and not by necessity. He is a free agent in a competitive market. He can shop; he can make comparisons of goods and of financing charges; he can take his time and he can wholly refrain from purchasing. His volition is uncontrolled. Furthermore, as has been pointed out above, he is protected, where the borrower is not, by the free and active forces of competition as between manufacturers and distributors of the goods of which he is a potential purchaser, plus the equally active competition between those engaged in the business of financing consumer-credit.[27]

CONCLUSIONS: At the beginning of this Commentary the writer stated his understanding of Mr. Berger's thesis to be as follows: Credit sales should, if possible, be held by the courts to be within the purview of existing usury statutes, and, whether such decisions are reached or not, the legislature should intervene to solve "the

[26] See Mr. Berger's statements referred to in his footnotes 31 and 32, p. 153.

[27] As stated by the State Banking Commission and Interim Advisory Legislative Committee in its Report to the Wisconsin Legislature (1935) at p. 60: "Therefore the Committee feels that the keen competition between automobile finance companies who are interested in time payment purchases will, when the public has full knowledge of all charges including reserves, rebates and 'packs,' reduce installment credit rates and charges to the lowest possible point."

problem of credit sales." In the comments appearing above the writer has attempted to point out the factual fallacies underlying Mr. Berger's conclusions. The fallacies of Mr. Berger's conclusions, however, may perhaps best be disclosed by adverting briefly to the consequences which would follow if Mr. Berger's views were accepted by the courts.

Usury statutes generally fix a maximum per annum rate of interest of 6 per cent or in the neighborhood of that figure. Accepting for the moment Mr. Berger's premise that the so-called finance charge should be treated as "interest," it would follow, if Mr. Berger's recommendations had had the force of law, that every instalment sale in connection with which the credit charge amounted to more than 6 per cent per annum would have been subject to the forfeiture and penalty provisions encompassed in usury statutes. It is universally recognized that consumer credit cannot be extended at the usual commercial borrowing rates of "interest."[28] It is apparent, therefore, that if the courts had accepted Mr. Berger's thesis and refused to follow the precedent of *Beete v. Bidgood* in exempting bona fide credit sale transactions from the operation of usury statutes, all of the many recognized benefits directly attributable to the growth of consumer credit would have been lost—to the detriment of the so-called "forgotten man" as well as to the industrial community as a whole.

Although the writer understands that Mr. Berger disclaims advocacy of any specific legislative remedies, it appears from a reading of his article that he would recommend some kind of legislative intervention in order to "protect" the consumer body. As already indicated in this Commentary, issue is taken with Mr. Berger on the question of the *need* for protection. It seems to the writer that Mr. Berger's views have been influenced, and, with due regard for the conscientious motives which have undoubtedly inspired Mr. Berger's efforts, distorted by undue emphasis on isolated cases of abusive practice, gleaned from reports of investigating committees whose tendency, as is generally true of investigating bodies, has been to over-emphasize the existence of the abuses being investigated. That abusive practices exist in the field of consumer credit, as they do in every phase of all business and economic life, is not denied. There have undoubtedly been many cases in which the instalment purchaser has been deceived and even defrauded. But remedies for fraud and deception exist in the law today, apart from usury statutes, and the remedies afforded by existing laws require no further implementing to give "protection" to the victims of fraud and deceit. Even more effective, moreover, is the two-fold influence of the competitive forces which exist, in the first instance, in the field of manufacturing and merchandising of consumer goods and, in the second, in the field which extends facilities for financing consumer credit. The major companies operating in the latter

[28] As stated in the Report to the Wisconsin Legislature, *supra* note 27, at p. 50: "However, it must be taken into consideration that cash and merchandise credit cannot be handled under regular commercial bank rates of interest. . . . It should be further realized that a small item of consumer credit entails as much detail as a large extension of credit in a bank. There are investigations, reports, follow-up correspondence, and a multitude of things necessary to furnish this service. There is much less overhead of this kind in regular commercial banking. . . ."

field, whether or not directly affiliated with manufacturers of the products whose sales they finance, are corporations equipped with substantial capital, are competently managed and conduct their business under high standards. They are today very large borrowers from the commercial banking system and, having at stake a substantial investment in the instalment financing field, it is reasonable to expect that they will exert every influence to eliminate such abusive practices as are bound to arise in an industry which has grown as rapidly as the business of instalment financing.[29]

If the legislative intervention which Mr. Berger has urged were to go so far as to subject the determination of credit prices to regulation by statute, it is submitted that it would then be invading even more dangerous ground. As has been pointed out in this Commentary, the essential elements entering into the determination of the time price of a commodity are no different from those elements which are inherent in the determination of cash price. It has ever been a primary rule of our economic system that the fixing of prices is a function in which government should not interfere; it has also been a cardinal principle of our constitutional government that the right of an owner to fix the price for which his property may be sold is an inherent property right and as such protected under the due process clause of the Fourteenth Amendment.[30] Whether the differential between the cash price of a commodity and the price at which it is sold on credit be termed "interest" or labeled with any other designation, in the last analysis the determination of the amount of this differential resolves itself into a question of merchandising "mark-up." The storekeeper who buys his merchandise on sixty days credit with a privilege of paying in ten days at a discount of 6 per cent of the amount of the purchase invoice saves $6 by anticipating fifty days on a $100 debt for merchandise. This is equivalent to interest at the rate of over 43 per cent per annum, but no one would seriously advocate the application of usury laws or regulatory legislation to such a transaction. This example only emphasizes how unsound would be the result if, by legislation, the buyer's discount

[29] Even such proponents of regulation as Messrs. Nugent and Henderson, whose various writings on the subject have been cited as authority by Mr. Berger, have admitted that "the major part of instalment selling and instalment financing is highly reputable." See Pollak Pamphlet 30, by L. R. Foster, Associate Director of the Pollak Foundation for Economic Research.

[30] It has repeatedly been held by the United States Supreme Court and other courts that the right of an owner to fix the price for which his property will be sold is an inherent property right and as such is within the due process clause of the Fourteenth Amendment. Wolff Packing Co. v. Court of Industrial Relations, 262 U. S. 522 (1923); Chesapeake & Potomac Telephone Co. v. Manning, 186 U. S. 238, 246-7 (1902); Tyson & Bro. v. Banton, 273 U. S. 418, 430 *et seq.* (1927); Ribnik v. McBride, 277 U. S. 350 (1928).

In Tyson & Bro. v. Banton, *supra*, at 438, the Supreme Court said: "Nor is the sale of ordinary commodities of trade affected with a public interest so as to justify legislative price fixing. This court said in Chas. Wolff Packing Co. v. Court of Industrial Relations, *supra*, p. 537: 'It has never been supposed, since the adoption of the Constitution, that the business of the butcher, or the baker, the tailor, the wood chopper, the mining operator or the miner was clothed with such a public interest that the price of his product or his wages could be fixed by state regulation. It is true that in the days of the early common law an omnipotent Parliament did regulate prices and wages as it chose, and occasionally a colonial legislature sought to exercise the same power; but nowadays one does not devote one's property or business to the public use or clothe it with a public interest merely because one makes commodities for, and sells, to, the public in the common callings of which those above mentioned are instances.'"

or the time-sale or charge account add-on to the cash price were required to be trans lated into terms of interest and then measured by fixed statutory standards similar to those in effect with respect to money-loans.

The Legislature of the State of North Dakota recently attempted to enact a regulatory statute for the "protection" of instalment-buyers.[31] The Supreme Court of the State gave the statute a construction which made it applicable only to *loans disguised as sales*. The opinion of the Court shows clearly, however, what the decision would have been, except for the saving construction which it applied,—namely that the law would be unconstitutional as a "price-fixing statute." The opinion of the Court is illuminating on the subject of the possibilities of such legislative intervention.[32]

The types of commodities which are regularly sold on credit are myriad; the selling terms vary with the commodity; variations in the financing plans which may be made available for different commodities sold on credit are frequent; the elements of cost, expense, and other overhead items and of course the element of risk are highly variable in their nature. To entrust to a legislative body the responsibility for determining the extent to which these varying factors should be reflected in the credit-price of every commodity sold on instalment terms would result in the interposition of government in business to an extent never before conceived of, even in these days

[31] Saylor v. Brady, 63 N. D. 471, 248 N. W. 673 (1933). The North Dakota usury statute, N. D. Laws 1933, c. 140, provided: "No person, co-partnership, association, or corporation shall directly or indirectly take or receive, or agree to take or receive, in money, goods or things in action, or in any other way, any greater sum or any greater value for the loan or forbearance of money, goods or things in action, than eight per cent per annum, and in the computation of interest, the same shall not be compounded. Any violation of this Section shall be deemed usury; provided, that any contract hereafter made, to pay interest on interest overdue shall be deemed usury; *provided further, that any evasion of this act by charging more for goods or chattels when sold on credit, or on deferred payments, or when sold under monthly or installment payments, shall be deemed usury whenever the total payments shall exceed the cash selling price, plus eight per cent interest.* Nothing in this act shall be construed by any court to excuse or legalize any past evasion of the usury law, or exonerate any person, firm or corporation that may have been guilty in the past of charging a usurious rate of interest, in violation of Section 6073 of the Supplement to the 1913 Compiled Laws of North Dakota, as amended by Chapter 274, Session Laws, 1927."

[32] The Court said (*id.* at 476, 248 N. W. at 675): "After reading the statute carefully and having in mind the consequences inevitably attendant upon any other construction, *we are forced to the conclusion that the Legislature did not by this amendment enact a price-fixing statute or forbid or penalize sales of personal property on credit or on deferred or installment payments at different and higher prices than those at which such property would have been sold for cash.* . . . The end at which the amendment statute aims is not the prevention of sales of the sorts enumerated, but the evasion of the prohibition of excessive interest through the device of such sales. *If, as plaintiff contends, the purpose of the proviso be to prohibit the sale of such property on time at a price greater than the cash price, plus 8 per cent interest on the deferred payments, though there be no intent to evade the usury prohibition, the effect is most extraordinary and far-reaching.* No farmer can sell grain or a horse or a thoroughbred bull on time, nor a hardware man a washing machine, nor a machine dealer a plow, nor a wholesale grocer to a retailer, nor any of them offer a discount for cash in thirty, sixty, or ninety days, where the time price is greater than the cash price plus interest at the rate of 8 per cent per annum on the deferred payments. And such instances can be multiplied without end. So it seems to us in applying the amended statute attention must be given to the facts in each particular case. If the sale be made in good faith and the time price be fixed at a sum greater than the cash selling price for any other reason than to evade the prohibition against usury, there is no transgression of the statute and no penalties attach, even though the difference be greater than the interest reckoned at 8 per cent on the deferred payments."

of advanced social and economic philosophy. The State Banking Commission and Interim Advisory Legislative Committee in its Report to the Wisconsin Legislature recognizes the danger of the regulation thesis, in the following language:

"It would appear to be a stupendous, if not an impossible, task for any rate fixing authority at this time to arrive at the rates on the various types of security when the different lengths of time and the different balances are taken into consideration. . . . Furthermore, the Committee feels that there are reasons in requiring a maximum rate on cash loans which do not exist under merchandise installment credit. In a great many instances, cash loans are predicated upon emergencies which are so urgent that the borrower will make almost any sacrifice to make a loan. This makes him an especially easy subject for exploitation."[33]

It is also significant that Dr. William T. Foster, Director of the Pollak Foundation for Economic Research which has reported the existence of a great many abusive practices in the field of instalment selling and instalment sales financing is definitely opposed to any form of statutory fixing of financing charges.[34]

An examination of the footnote references appended to Mr. Berger's treatise discloses that the sources of Mr. Berger's factual information have been largely confined to writings and reports of those whose evident purpose it was to ascertain and report upon the abuses existing in the field of instalment selling and instalment sales financing, rather than to weigh, by a thorough-going study of the entire subject matter, the benefits which have been derived from the wise extension of consumer credit and consumer credit financing against the occasional abuses of a small minority of those operating in this field. The writer of this Commentary is convinced that Mr. Berger's approach and his conclusions would have been entirely different if there had been made available to him the background of facts which the writer has attempted to set forth in this Commentary.

[33] At p. 59.

[34] An unqualified statement to this effect was made by Dr. Foster before the Joint Committee on Banks and Banking of the Senate and House of Representatives of the Commonwealth of Massachusetts at a public hearing (at which the writer of this Commentary was present) on various proposed legislative measures relating to the field of consumer credit. See also Foster and Foster, *Rate Aspects of Instalment Legislation*, *infra*, p. 198. The Consumers Advisory Board has taken the same position as Dr. Foster. *Id.* at p. 193.

RATE ASPECTS OF INSTALMENT LEGISLATION

William Trufant Foster* and LeBaron R. Foster†

A realistic approach to the problem of instalment credit charges requires concentration on conditions as they are. It should not mark off sectors of the field with boundaries determined by theoretical concepts; nor should it ignore all but a few outstanding agencies, such as the largest finance companies and the largest merchandise distributors. It should embrace the whole field.

To draw an accurate statistical picture of such a large field, however, is impossible with the meagre materials at present available. We do not know how large is the whole; we do not know the size even of any of the constituent parts. We do not know the dollar volume of instalment sales, the volume of instalment credit outstanding at any one time, nor the average rates charged for that credit. Fortunately, we do not need to know any of these things in order to appraise the social worth of present methods of instalment business conduct. Large numbers of case studies, distributed over many states and many commodities, show clearly the nature of the problem.

We assume at the outset—considerable evidence to the contrary notwithstanding—that the consumer is interested in the price he pays for anything, whether that price is for merchandise or for credit granted in connection with the sale of merchandise, and that he would make comparisons of credit costs if the necessary information were provided in sufficiently plain terms.

Does the consumer in fact get that information? In search of an answer, let us consider what we found in one Mid-Western state.[1] In the sixty stores visited, there were at least twenty-four plans in operation. These twenty-four plans, grouped according to the methods of stating the credit charge, fall into eight broad classifications: (1) a flat dollars and cents charge, with the system for determining that charge undisclosed; (2) a discount from the advertised or list price for cash payment, granted in some stores only if the customer demands it; (3) a flat percentage levied on the

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[1] For the method of the study, and the complete table of rates, see LeBaron R. Foster, *Instalment Credit Costs and the Consumer*, (Jan. 1935) J. Bus. U. of Chi. 27-45.

cash price, before the down payment is deducted; (4) a percentage per annum levied on the original unpaid balance; (5) a flat percentage, without relation to the length of the terms, levied on the original unpaid balance; (6) a percentage per month on the actual unpaid balance outstanding in each month; (7) "no charge" for instalment credit; (8) a combination of two or more of the above plans.

To shop intelligently, the consumer has to take into account not only all these differences, but many minor variations as well. Some firms require advance payment of the carrying charge with the down payment. Others levy dollars and cents charges which do not check with the advertised percentage plan. Still others refuse to divulge credit terms until the customer has definitely decided to purchase.

We should bear in mind, moreover, that the charges revealed in this study are simply those imposed at the time of purchase. Later in the life of the contract, less reputable dealers, on one pretext or another, sometimes add extra fees. And if the buyer deviates from the exact terms of the contract, he often becomes subject to fines and penalties for irregularity, with no check on the size of those fines other than the seller's self-imposed check of "business expediency."

Now if the customer wants to compare costs of credit at the various available sources, he has only to take his pencil and his courage firmly in hand, and with plenty of time and paper proceed to reduce to a common denominator the differences of price, down payment, length of terms, size of payments and percentage or dollar credit charge. It is not astonishing that few ever attempt such a task!

If credit costs were reasonably uniform, the consumer could ignore these manifold variations in methods of statement; but it is a fact that costs vary widely. In the study just cited, annual cost rates were computed for more than 100 cases.[2] Grouped by commodities, the rates ranged as follows:

	Per Annum Rate
New Automobiles[a]	21.9% to 32.9%
Used Automobiles[a]	34.8% to 47.1%
Refrigerators	8.3% to 51.8%
Furniture	6.0% to 55.5%
Radios	11.5% to 98.3%
Automobile Tires	33.6% to 106.1%
Stoves	0% to 68.6%
Other Commodities	0% to 103.7%

This study does not include extreme cases: the attempt was made to sample the terms which were most frequently used in a given store to finance the sale of a given commodity. Furthermore, the study does not include those unconscionable concerns which send salesmen into the field to contact workers at their homes and places of work, taking wage assignments as security. With such cases included the upper

[2] The annual cost rate is the ratio of the credit charge (the time price minus the cash price) to the average amount of credit extended for one year, expressed as a percentage. For a comparison of the computation method used in this study and other common methods, see LeBaron R. Foster, *supra* note 1.

[a] Includes fire, theft, and sometimes collision insurance.

limits would be far higher. It should be observed that in those few cases where the rate was found to be zero per cent, instalment terms were so short that the average credit extended was less than on ordinary charge accounts.

A comparison of the rates disclosed in the above study with the rates found in a briefer survey conducted in metropolitan Boston discloses no significant differences. The extremes are more pronounced; one Boston store which granted long credit terms refused to make any concession from its instalment price for cash payment, and a small radio shop imposed a credit charge which resulted in a rate of 353 per cent. But in nearly all cases, instalment rates on a given commodity purchased in a given class of store fell within the ranges observed in the Middle West.

For another study of rates we are indebted to Professor Lewis A. Froman of the University of Buffalo.[3] The following is a summary of his tables:

	Per Annum Rate
New Automobiles ("one of the largest and most representative automobile finance companies")	14% to 38%*
Electrical Appliances ("large eastern public utility company")	13% to 23%
Electrical Refrigerators ("one of the largest general finance corporations")	14% to 30%
Mail-order Goods ("a well-known mail-order house")	13% to 66%

* Rates do not include mandatory insurance charge.

Here the ranges represent the difference in cost between long terms on large amounts of credit and short terms on small amounts of credit. Though representative of only a part of the instalment financing business, they probably are typical of large, efficient concerns which charge enough to meet credit costs. However, it is important to bear in mind that the finance company rates do not include the "pack," or extra charge, which the dealer often adds for his personal profit.[3a]

We know, then, that rates may be very low or very high. We know, likewise, that the consumer rarely can figure the true rate for himself from the confused terms in which charges are stated. We may add to these deductions the fact that the consumer cannot rely on the percentages frequently quoted as the basis for charges, even when they appear to be clear and exact. In the Mid-Western study, only one store out of 60 described its charges in terms of a true percentage rate. That store, isolated on its isle of honesty, might ironically be charged with deception: it was not playing the game of deceiving its customers. Among the other stores, the quoted rates showed so many degrees of variation from the actual rates that it was not possible for a customer to draw any conclusions as to comparative costs.

Patently, the need is for a uniform, accurate, outspoken method of statement, universally applied wherever instalment credit is granted. To be doubly useful, the method should permit comparison not only among various sources of instalment merchandise credit, but also with sources of cash credit. Although there are dif-

[3] Froman, *The Cost of Instalment Buying* (1933) 8 HARV. BUS. REV., 227.

[3a] The problem of the "pack" is discussed in, Cavers, *The Consumer's Stake in the Finance Company Code Controversy*, *infra*, at p. 204 *et seq.*

ferences between merchandise loans and money loans, the two may be used for the same purpose, and are in fact so used to some extent today.

What are the alternatives? We might fall back on the commercial banking custom of discounting interest in advance, in accordance with the current practice of industrial or Morris-Plan banks and personal loan departments of commercial banks. But the discount method always makes the rate appear lower than it is. On a straight loan maturing at the end of one year, 10 per cent discounted in advance is equivalent to a true rate of 11.1 per cent. And on an instalment loan, the method does not reflect the periodic reductions of the principal through repayments, except when repayments are treated as deposits and interest is paid on them. As a consequence, the true rates for such loans are always several fathoms below the surface. For example, a 10 per cent discount on a one-year loan repayable in equal monthly instalments, with interest at three per cent credited on repayments, results in a true rate of approximately 18 per cent.

Typical of discounted instalment loans which do not involve interest credits on repayments are those guaranteed by the Federal Housing Administration. As late as March, 1935, an Administration official said: "The interest rate is arranged locally between the borrower and the local lending agency, except that it may not exceed five per cent per annum."[4] And a federal government advertisement said that the yearly interest charge was $5 for each $100 borrowed. Possibly the government should not be blamed for falling into line with the standard practice of the banks which are to make the loans. Discounting is their method and their habit. But there is no excuse for misinforming consumers in official pronouncements which are intended only for consumers. In the first place, when $100 is discounted at five per cent the borrower receives an actual advance of only $95. Further, the loan is repaid periodically by instalments, with the result that the borrower has, on the average, the use of only a little more than half the original advance. The result is a true rate of 9.7 per cent per annum, not five per cent. The borrower should not be required to pay interest on the discounted interest, nor on the principal he has paid back.

Another alternative is the method, common in department stores, of charging an annual percentage on the original unpaid balance. The first objection is that the method calls the rate something that it is not; a six per cent rate may work out to anything from six to 12 per cent, depending on the length of the terms. Another objection is that some sellers take advantage of the buyer's assumption that the rate is annual, when in fact they apply the full percentage for a period of six or eight or ten months. Again, the method results in the highest rates on the longest terms, whereas it is on the longest terms that the cost to the credit grantor is lowest.

With one exception, all the other methods in common use are open to similar misunderstanding and abuse. The one exception is the statement of the credit charge, including interest, investigation, service, commission, bookkeeping and all

[4] Ward M. Canaday, Director of Public Relations, Federal Housing Administration, *A Better Place in Which to Live*, RURAL PROGRESS MAGAZINE, March, 1935, p. 3.

other charges and fees of every description, as a per cent per month on the average balance outstanding in each month. This is the method successfully employed in the administration of small loans under the Uniform Small Loan Act. It does not permit juggling of discounts, down payments, percentages, advance payments or fees. It provides an automatic method for figuring rebates of carrying charges, in case the buyer repays any part of the principal before the due dates. And it conforms realistically with the costs of granting credit: the seller collects the largest part of the carrying charge in the early part of the contract, when his costs are highest, and the smallest part towards the end of the contract, when his costs are lowest. The one plausible objection is that it might present some administrative difficulties in the financing of the smallest balances, particularly while the credit personnel was becoming accustomed to the change in routine.

Granted that a uniform, clear, outspoken method of instalment cost statement is desirable, how may it be brought about? Not by the individual instalment seller. A few furniture and piano stores, to be sure, have adopted the per cent per month method, but the great majority apparently believe, and with some reason, that if they told the truth about their rates they would lose business to competitors who continued to disguise or conceal their rates. Only before an enlightened buying public could the truth teller gain the advantages of his frankness, and education of the buyer will be slow as long as each instalment buying experience further confuses him.

What each cannot do singly might be done collectively through the trade organization. But the attitude of the largest finance companies and of their trade organization is that a comparison of dollar charges for credit is good and sufficient; that an interest rate approach to the problem is inexpedient, since, they say, the instalment financer does not make a loan but simply renders a service; that buyers are not interested in percentages. The finance companies contend, in short, that present methods of stating rates are adequate.

Nor does there appear to be much to expect from the NRA codes. For eighteen months the Consumers' Advisory Board has been asking that provisions be inserted in the Retail Trade codes, requiring accurate percentage statement of instalment credit carrying charges.

The official statement of the Board's position is:

1. "Whenever goods are sold on deferred payment the seller performs two distinct and separate functions—the sale of merchandise, and the extension of credit for which a charge is made.
2. "Whenever a charge is made for the extension of credit this charge, like the price of merchandise, should be stated in terms which make it readily comparable with all prices for the use-of-money repayable in monthly installments.
3. "There is only one accurate way to express the price of the use-of-money—by a given percentage on a given principal for a given time. Any other method of statement permits juggling with one of the two variables,—principal and time.

4. "In installment credit the outstanding amount of credit declines from month to month. Therefore, the only accurate and outspoken way to express the charge for this type of credit is in terms of a given percentage on the current unpaid monthly balance."

In not a single NRA code has such a provision been adopted. Though the Roosevelt Administration is becoming increasingly aware of the need for consumer protection, so far codes have been framed for the most part in the interests of business and labor.

If truthful rates are not to come voluntarily, they may come coercively through state laws. In the forefront of the movement stands Indiana. When, in March, 1935, the Legislature passed and the Governor signed the Retail Instalment Sales Act, the State distinguished itself as the first to pass a comprehensive law regulating the business of instalment selling and financing. As introduced, the Bill (H. 377) contained several provisions bearing directly on rates, chief among which were the following:

(1) "No retailer may collect or receive a greater rate of interest than two-thirds of one per cent (2/3 of 1%) per month on the principal balance owing on any retail instalment contract from any retail buyer . . . " " . . . interest may not be collected in advance and shall be computed only on the number of days the principal balance or any part thereof remains unpaid." This restriction was to apply only to unlicensed retailers.

(2) Licensees of the state banking department, on the other hand, were to be allowed to collect or receive any lawful rate of interest contracted for in the retail instalment contract. The department was to be empowered to fix a fair maximum rate of interest—either a single rate or a series of rates established by classes, and to prescribed maximum fees where fees were to be permitted. The annual license fee was to be $100.

(3) Banks and trust companies were to be restricted to an interest rate of 1½ per cent per month upon the principal balance owed.

The Bill ran the gauntlet of legislative amendment. Rate features were radically altered. All references to finance charges as interest and all requirements for statement of finance charges on a percentage basis were eliminated. In their place were substituted rigid requirements for accurate statement of the dollar amounts of carrying charges. Section 4 provides:

"Every written instrument evidencing a retail instalment sale shall recite. . . ..

"(1) The cash price of the specific goods.

"(2) The amount in cash of the retail buyer's down payment, whether made in money or goods or partly in money or partly in goods.

"(3) The unpaid balance. . . ."

"(4) The cost to the retail buyer of any insurance the retail seller has agreed to procure, if the retail seller has agreed to purchase the insurance and extend credit to the retail buyer for the price thereof.

"(5) The principal balance owed on the retail instalment contract which is the sum total of items (3) and (4).

"(6) The amount of the finance charge.

"(7) The time balance owed by the retail buyer to the retail seller and the number of instalment payments required and the amount and date of each payment necessary finally to pay the time balance which is the sum total of items (5) and (6)."

The price of the insurance may be included in the finance charge, and item (5) omitted; but if this procedure is followed, the retail seller shall, within twenty-five days, mail the retail buyer a statement reciting the separate amounts of items (4) and (6).

But the teeth of the regulation rests, potentially, at least, in Section 6:

"The finance charge contracted for in any retail instalment contract may not exceed the maximum finance charge then authorized by the department. . . .

"Every retail buyer shall have the right, at any time, to pay the then unpaid time balance owed. . . . The department shall and is hereby authorized to fix and determine the amount of any discount to be given for prepayment. . . ."

As finally passed, therefore, the Act attempts to establish satisfactory instalment rates, not by providing buyers with a uniformly applied yardstick of credit costs, but by authorizing the Department of Financial Institutions to limit and watch over charges. Thus, presumably, consumers are safeguarded against exorbitant carrying charges. Unfortunately, however, the law does not require the seller to provide sufficient information to enable the buyer to make cost comparisons. Little better than before this law was passed can the individual purchaser tell whether he may obtain credit most cheaply from store A, from store B, or from any one of several sources of money loans.

Many other bills are now (March, 1935) before state legislatures.[4a] Illustrative of provisions affecting rates are those summarized below:

ARKANSAS

House Bill No. 275.

Financing agencies must designate what part of the carrying charge is interest, and "when said amount of interest taken together with any other charge for handling or carrying charge exceeds ten per cent per annum it will be usury." Instalment sellers who take conditional sales contracts are placed under a similar restriction. Insurance charges may not be included in the carrying charge, but must be treated separately.

INDIANA

House Bill No. 373.

This amendment to the banking laws empowers banks and trust companies to make Federal Housing Administration loans, but provides that "any bank or trust company shall have power to make loans or advances or credit for a period not to exceed one year and in amounts not exceeding one thousand dollars, repayable in installments, upon the security of co-makers, personal endorsement or the pledge or mortgage of personal property or choses in action and to charge therefor and a rate

[4a] EDITOR'S NOTE: Of the bills discussed below, the Michigan bill has passed the House, and is now (May, 1935) before a Senate committee. The other bills have failed of enactment.

of interest thereon not exceeding one and one-half per cent per month upon the unpaid balance of any such loan, provided that it clearly appears upon the face of the instrument evidencing such loan that the rate of interest charged thereon is to be computed upon the basis of the stated rate per month upon unpaid balances; and no other or additional charge shall be made for any such loan, except recording fees, if any, actually paid."

MASSACHUSETTS

Senate Bill No. 55.

This bill governs, through licensing, all persons regularly engaged in the business of selling personal property of a value of $1000 or less on conditional sales contracts, bailments and leases, and all persons regularly engaged in the business of financing or refinancing sales of personal property and services rendered to a consumer of a value of $1000 or less.

Rates are not restricted, but the contract, a copy of which must be given to the buyer, shall "state with substantial accuracy [in the contract] all the terms and conditions of the contract and shall include: the cash market value of the goods or services; the down payment in dollars and cents; the original balance financed; the number of weeks or months covering the duration of the contract; the amount of the weekly or monthly payment in dollars and cents; the interest, service charges or credit charges stated both in dollars and cents, and as a per centum per month, calculated on the average unpaid balance outstanding in each month." "The interest, service charge or credit charge shall include all charges for interest, service, investigation, bookkeeping and all other charges made in connection with the contract. No other charges, bonus, fee, expense or demand of any nature whatsoever shall be made so long as the buyer fulfils the conditions of the contract; and no fines, penalties or charges shall be made for delay, delinquency, repossession, refinancing, legal expense or other cause unless such charges are specifically set forth in the contract both as to amount and as to the conditions under which they may be imposed."

Where the seller places a policy of insurance to cover his insurable interest in the article sold, the amount of insurance, the kind of insurance, and the premium paid shall be stated in the contract, and the premium shall be added to the item of the original balance financed.

Senate Bill No. 4.

All those engaged in the business of financing or refinancing the purchase of personal property shall be licensed, and the Commissioner of Banks is empowered to issue rules and regulations and to examine licensees.

House Bill No. 805.

This bill contains provisions similar to those in Senate Bill No. 4, above, and in addition provides that the Commissioner shall establish a rate "which shall not in the aggregate exceed an amount equivalent to ten per cent per year on the amount

actually loaned or advanced for the account of the purchaser." Interest shall include all sums paid by, for or on account of the purchaser, for or on account of making the advance.

Michigan

House Bill No. 459.

As originally introduced, the bill contained provisions requiring adequate informing of the buyer as to all credit terms and costs, including the statement of the carrying charge as a per centum per month calculated on the average unpaid balance outstanding in each month. But the Committee on Judiciary recommended a substitute for passage, which was adopted. The substitute requires merely that seller shall provide the buyer with a copy of the chattel mortgage or conditional sale contract, and that the contract shall recite:

"(1) The cash price of the specific goods.
"(2) The amount in cash of the retail buyer's down payment whether made in money or goods, or partly in money or partly in goods.
"(3) The unpaid balance of the cash price payable by the retail buyer to the retail seller which is the difference between items (1) and (2).
"(4) The amount of the finance charge stated in dollars and cents.
"(5) The time balance owed by the retail buyer to the retail seller, and the number of installment payments required, and the amount and date of each payment necessary finally to pay the time balance which is the sum total of items (3) and (4)."

The only restrictive feature is provided in Section 4: "No Finance Charge by the Seller shall be charged, contracted for or received in excess of the finance charge that shall have been advertised, printed or displayed in any publication or written communication of the Seller."

The bill does not require a separate statement of the cost of insurance included in the finance charge, nor does it in any other way alter the present practices of reputable sellers. However, the passage of the bill would accomplish one important purpose: it would establish the right of the state to regulate instalment selling.

New Hampshire

House Bill No. 253.

"It shall be illegal for any company operating within the state to make charges in excess of fifteen per centum per annum, of the valuation of any automobile for loaning money to purchase said automobile."

New York

Assembly Bill No. 940.

The banking laws covering loans of money, credit, goods, or things in action of a value of $300 or less are extended to include the purchase of notes or bills at a discount. Presumably the intent is to bring under the small loan law industrial banks

and others lending small sums on a discount basis. However, through judicial interpretation instalment finance companies might conceivably be included.

In these bills is displayed a wide range of regulatory theory and application. In some, a destructively low rate is set; in others, the rates now governing small loans are applied; in others, no legal maximum is established. In general, the underlying philosophy may be divided into two schools of thought: (1) the consumer can be protected from exploitation only by setting a legal maximum rate, and (2) where competition is reasonably free the consumer is adequately protected when he is informed as to the true size of credit charges, in terms of a uniform, clear standard. The second point of view seems to be favored both by the theoretical objection to price fixing and by the failures of price fixing in practice.

Again the argument rests upon a realistic approach. Retail instalment selling at present is employed in sales varying all the way from $5, with payments spread over a few weeks, to three thousand dollars, with payments spread over three years. A large part of the costs of granting credit are fixed. Cost of legal forms, bookkeeping, credit investigation, routine collection and filing are about the same for a small contract as for a large contract. The spreading of these fixed costs over a small balance and a short term inevitably results in a high percentage rate. Yet under some circumstances the buyer may find it well worth while to pay the high rate rather than go without a needed purchase.

To illustrate: representative instalment terms on tires are a down payment of 10 per cent, the balance plus 10 per cent of the cash price to be paid in 10 weekly instalments. Because of the brief period of repayment, the rate is 105 per cent. Yet the buyer, if unable to scrape together $10 for a new tire, might willingly pay the $1 carrying charge rather than go without the use of his car until he had saved $10. If one dollar a week was all that he could spare from his wages, his car might lie idle for two and one-half months.

The advocate of an arbitrary legal maximum rate might hold that, since the buyer pays an improvidently high rate for the credit, he should be protected against his own folly. But who is to draw the line? The impoverished housewife who can save money by doing her own washing in a washing machine, the salesman who cannot reach his customers without a car, the long-unemployed clerk who has at last found a job but who cannot pay cash for the necessary clothes, all these and countless others may profit from purchasing on the instalment plan, even at high rates. The great majority must either obtain consumer credit, which usually means expensive credit, or go without the needed goods. No one but the individual can decide whether the credit is worth the price. The one protection which might be provided by law, without limiting the scope of the service, is the requirement that sellers state their charges in accurate, comparable terms.

Is instalment credit too expensive? Who can say? Certainly it is more expensive than it will be a few years hence. But lower rates will come through improved

methods of doing business or through increased competition, not through legislative enactment. Experience in the small loan field proves that the setting of an arbitrary maximum rate below the level at which lenders can meet costs merely deprives borrowers of a valued loan service.

Should some state enact a low maximum rate, of fifteen per cent per annum, for example, the effects logically to be anticipated are: (1) elimination of instalment selling as a credit instrument for sellers who impose carrying charges adequate to meet costs; (2) increased business for firms which cover a substantial part of credit costs in their "cash" prices, with the result that cash buyers pay for credit whether they take it or not; (3) evasion and underhanded dealing on the part of the less reputable sellers.

Possibly in the end it will be found that a legislated maximum rate is fairest to both consumers and sellers. But until trial and error with more liberal regulatory measures has provided a background of experience, legislatures will do well as an initial step to bring the business under regulation and supervision. Presumably that is why sponsors of the Indiana Bill were content to allow the striking out of features which were most objectionable to the instalment finance business. Once the state has established its power to control—to license, to investigate records and accounts, to issue rules and regulations, to fix maximum rates—then the moulding of policy and the strengthening of legislation to deal with new situations as they arise, or with old needs as they become clarified, should follow as a matter of course.

THE CONSUMER'S STAKE IN THE FINANCE COMPANY CODE CONTROVERSY

David F. Cavers*

A consideration of instalment selling problems as they affect the ultimate consumer cannot disregard the rôle played by the finance company. But for the development of the finance company, instalment credit could never have expanded to its present tremendous proportions. Certainly this is true with respect to the merchandizing of automobiles, and the automobile has long held a place of preëminence among commodities sold on instalment credit.[1]

The finance company does not lend directly to the purchasers of goods the sale of which it finances, but in discounting the notes given by such purchasers to the retail dealer, the finance company is in a position to determine at least the minimum credit terms which time purchasers must meet. Since, as will be seen, the financing of instalment sales is a highly competitive business, it becomes important to examine the practices of that business to ascertain their influence upon the cost to the consumer of instalment credit financed through these agencies.

This inquiry into competitive practices in the sales finance business is facilitated by the effort on the part of the "finance company industry"[2] to regulate those practices by the adoption of a Code of Fair Competition under the National Industrial Recovery Act. These efforts, which led to the submission of a code in September, 1933, on which a public hearing was held the following month, were not successful, nor have they as yet been successful, in bringing about the adoption of any code by

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[1] Milan V. Ayres, Analyst of the National Association of Finance Companies, estimated the volume of instalment credit lent in 1925 at $4,066,000,000. Of this amount, nearly $2,300,000,000 represented automobile financing. See Clark, Financing the Consumer (1930) 17. Professor Seligman's study of the extent of instalment credit for the same year brings the average amount of instalment credit about 20 per cent lower, but the predominating position of the automobile remains unchallenged. 1 Seligman, Economics of Instalment Credit (1927) 117-119. Of an estimated instalment sales volume in 1931 of $1,355,000,000 for new automobiles, refrigerators, radios, furniture, sewing machines, vacuum cleaners, and oil burners, automobiles comprised over 50 per cent, $697,500,000. *The Anticipated Dollar* (Jan. 1933) 7 Fortune 68, 69. Moreover, the proportion of instalment sales handled through finance companies is especially high in the case of automobiles. 62.5 per cent of the new automobiles sold in 1931 were purchased on instalment credit. *Ibid.*

[2] It may seem anomalous to apply the term "industry" to a business of this character, but, under the nomenclature of the NRA codes, all businesses became "trades" or "industries." The term "finance company industry" was used in the code proposed for sales finance companies.

this industry. The discussions which centered about proposals for a code have, however, rendered available a considerable body of information concerning competitive practices within the industry, upon which this study is based.

Before undertaking a discussion of these practices, it is first essential to examine the composition of the industry itself, an inquiry which will throw light on the difficulties encountered in formulating a code acceptable both to a numerical majority of its constituent organizations and to a majority in terms of the volume of business done.[3]

THE ORGANIZATION OF THE INDUSTRY

The financing business as comprehended by the code proposed for the finance company industry does not extend to the making of direct loans on chattel security but is limited to the purchase of receivables (contracts, notes, drafts, title retention instruments, etc.) held by dealers in commodities sold on credit. However, some companies engaging in sales financing also engage in the making of direct loans. The business does embrace the financing of commodities sold by wholesalers as well as by retailers, but the problems relating to this branch of the business are without the scope of this paper.[4]

Although to an increasing extent finance companies participate in the financing of other commodities than automobiles, the automobile business furnishes, it has been estimated, a total of 90 per cent[5] of the total volume of receivables financed. The bulk of this business is concentrated today in the hands of three companies, General Motors Acceptance Corporation (G. M. A. C.), Commercial Investment Trust, Inc. (C. I. T.),[6] and Commercial Credit Company (C. C. C.). The first of these is a subsidiary of General Motors Corporation; the other two have affiliations with a number of automobile manufacturers[7] including General Motors' principal competitors, the Commercial Investment Trust, through its subsidiary, the Universal Credit Company, with Ford, and the Commercial Credit Company with Chrysler. These companies are known to the trade as the "Big Three," a term which I shall employ for convenience in reference. In 1933, the capital and surplus of the Big Three totalled $179,500,000, about 63 per cent of the total capital and surplus of $266,700,000 of all units of the industry reporting their net worth to Dun and Bradstreet, Inc.[8]

[3] The NIRA requires that groups proposing codes be "truly representative" of their respective industries. NIRA, Tit. I, §3 (a) 49 STAT. 196 (1933), 15 U. S. C. A. (Supp. 1934) §703 (a). In the interpretation of this provision by the NRA, it has been the general—but not the universal—practice to require that both the criteria indicated in the text above be met.

[4] The textile factoring business was expressly excluded from the submitted Finance Company Industry Code.

[5] See Statement of Robert P. Babcock representing the Code Committee, *Hearing on a Code of Fair Competition for the Finance Company Industry*, NRA, Oct. 26, 1933, 39. (The record of the hearing on this code will be cited hereinafter as "*Hearing*.") This estimate excludes the factoring business.

[6] This company has acquired the Universal Credit Company which has affiliations with Ford.

[7] The precise character of the contractual relations constituting these "affiliations" is not known. It is believed that the manufacturer undertakes to recommend the affiliated finance company to his dealers and their customers.

[8] See Exhibit H filed by the Code Committee at the code hearing. Apparently all but a small portion of the industry in terms of net worth is included in this figure.

The total volume of business of the Big Three has been estimated at 75 per cent[9] of the entire volume of business handled by the industry.

The remainder of the business is in the hands of a large number of companies, estimated in October, 1933, to total 785, of which 212 did not operate in the automobile finance business.[10] The companies include two (termed "semi-nationals") which operate over a considerable territory, but most of them operate either locally or over a relatively restricted regional area. They do not have affiliations with automobile manufacturers. These companies will be referred to herein as "the independents." (It should be remarked at this juncture that the Big Three do not finance all the sales of the automobiles manufactured by the companies with which they are affiliated.)

OPERATING METHODS IN THE INDUSTRY

Not only is there a marked difference in size and scale of operations between the Big Three and the independents but there is a significant difference in their operating procedure. A finance company enters the retail sale transaction through the sale and indorsement to it by the dealer of the car purchaser's note for the unpaid balance and financing charges on the purchased car. As the business originally developed this indorsement was with recourse, *i.e.*, it subjected the dealer to liability on the note in the event of default by the maker-purchaser. About 1920 some finance companies began to operate a non-recourse plan: *i. e.*, the purchaser's note would be indorsed by the dealer to the finance company without recourse, thereby freeing the dealer from all liability on the contract. The dealer was paid the cash price at the time of sale, the difference between the cash price and the time price being absorbed by the finance company. Since the recourse of the finance company in such a transaction was against the purchaser only, the importance to the finance company of scrutinizing each transaction to determine the credit risk involved was materially enhanced. The burden of collection and of realization on the security in case of default was also assumed by the finance company. The non-recourse plan consequently offered a very real attraction to the dealer in relieving him of these responsibilities; it also imposed duties on the finance companies employing it which could best be discharged by companies which operated locally and were enabled thereby to keep close watch over the purchasers whose notes they held.[11]

The additional services rendered by the non-recourse companies led at first to the imposition of higher rates to the dealers on paper discounted on this plan. But as the non-recourse business became more firmly established, the demand for cars being high and repossession losses low, competitive conditions began to bring rates to the dealer between companies operating on that plan and those operating on a recourse basic closer together. In the meantime however, a significant development was

[9] Statement of Harry B. Dyer, Central Acceptance Corp., Cincinnati, Ohio, *Hearing*, 165.
[10] See Exhibit H, *supra* note 8.
[11] For a discussion of the two plans, see 1 SELIGMAN, *op. cit. supra* note 1, 75-81.

taking place in the practice of companies which had heretofore operated on the recourse plan. The repurchase plan was introduced.

Under this plan the dealer does not undertake unlimited liability on the paper indorsed by him but does obligate himself to repurchase cars repossessed by the finance company on default by the purchasers. The repurchase price is fixed at the unpaid balance due on the purchaser's note, and may include expenses incurred by the finance company in repossessing the car. The dealer is not obligated to the finance company in the event of the loss or destruction of the car.[12] Other immunities were granted him as repurchase experience became wider and finance companies could act as self-insurers against certain of the risks.

The repurchase plan was accompanied by an arrangement known as the dealer reserve,[13] for the protection of the dealer against losses incurred by him in the resale of the repossessed car. A certain percentage of the amount of each receivable discounted was set aside by the finance company as a reserve to the account of the dealer. In the event of a repossession loss, his reserve was available to absorb it, so that the dealer was liable to make further payment to the finance company only to the extent that repossession losses exceeded the amount of accumulated reserves to his credit. When reserves exceeded a percentage fixed with reference to the total receivables outstanding against the dealer, the excess was paid to him by the finance company to offset any losses which he might incur. For the efficient dealer whose repossession losses were few, the reserve might thus afford a source of additional income.

The repurchase agreement coupled with the dealer reserve was, needless to say, a powerful competitive weapon in the hands of the Big Three.[14] It enabled them to maintain uniform their rate structure with respect to the financing charges paid by automobile purchasers and at the same time permitted them to meet the competition of the non-recourse companies in the localities where these were strongest by restricting the risk which the dealer had formerly assumed under the recourse agreement and by providing for compensation against losses. In addition, the accumulation of

[12] See Statement of Harry Weiss, National Bond and Investment Co., *Hearing*, at 114, quoting from "a bulletin issued by the largest repurchase automobile finance company, in July, 1933." According to this bulletin the dealer is relieved from liability:

1. For damages which are the direct result of a collision, provided the repossession took place because of such collision.
2. In case of conversion of an automobile.
3. In case of confiscation of an automobile by federal or state authorities.
4. If a "repossessed car is not returned to the dealer before the account is 90 days delinquent."

Mr. Weiss asserted that "the dealer protective agreement has been broadened far beyond its meaning in that these larger repurchase finance companies reimburse the dealers for damages to repossessed cars not caused by collision, but instead, extraordinary wear and tear and other causes." *Id.* at 115.

[13] The dealer reserve device may be, and apparently is, employed by finance companies operative on a recourse basis but not employing repurchase agreements.

[14] It should be observed that these plans are not employed exclusively by the Big Three, nor do they use them in all their transactions. Some independents conduct a recourse business with or without the repurchase plan. Still more handle both recourse and non-recourse transactions. Non-recourse business is, however, characteristic of the great majority of the independents.

funds to the dealer's account in the hands of the finance company tended very naturally to the maintenance of relations between him and the company.[15]

Many of the non-recourse companies responded to the pressure of this competition, not by the reduction of rates to the purchaser, but by the payment of bonuses to dealers financing through them. This practice was not nation-wide. It was most general in the Middle West.[16]

As operated by most companies, apparently the amount of the reserve credited to the dealer under the repurchase plan and the amount of the bonus paid under the non-recourse plan was not fixed but varied from dealer to dealer, depending chiefly on competitive conditions.[17] As competition grew more acute with the onset of the depression, these practices extended until they threatened in some localities to undermine the stability of the sales finance business. Moreover, especially in the Middle West, dealers, who themselves were hard-pressed by lowered commissions on a lowered sales volume and by the necessity of granting increasingly large trade-in allowances, began to take advantage of the situation created by competition among the finance companies for their business.[18] Not content with the reserve or bonus offered them by the finance companies, some dealers began the practice of "loading" the finance charge with an extra charge, apparently calculated with reference only to what the traffic would bear. This sum, the "pack," merged in the finance charge and invisible to the car purchaser, was collected by the finance company as part of the contract, but the dealer retained it immediately as a part of his payment for the paper by the finance company.

PROPOSALS FOR CODE REGULATION OF THE RESERVE, BONUS, AND "PACK"

The situation created by these practices was thoroughly unsatisfactory to the vast majority of finance companies. No doubt it would have been still more so to the consumers who footed the bill, but they were innocent of any knowledge of the tribute levied on them.[19] The companies, however, faced the problem which faces every business in which business-buying becomes a competitive practice: no single company dared abandon the practice without the assurance that its competitors would reform also; and until June, 1933, there was no apparent way of assuring simultaneous reformation. The enactment of NIRA seemed to offer an outlet from the impasse. The National Association of Finance Companies (N. A. F. C.),[19a] with

[15] In the event that the dealer severs his relation with the finance company, apparently the practice is to withhold these reserves until the outstanding receivables have been retired.

[16] It has been said not to exist in New England. Statement of D. W. Hinckley, Ass'n of New England Finance Companies, *Hearing*, 63.

[17] "Deputy Whiteside: Do these rates vary up and down according to business conditions by a single company or are they fairly fixed? Mr. Babcock: They vary in accordance with competition, I believe, rather than in accordance with economic conditions." *Hearing*, 36.

[18] "Today the first question any dealer asks when you solicit business is 'How much rebate do I get?'" Statement of D. B. Cassatt, Interstate Finance Corp., Dubuque, Iowa, *Hearing*, 127.

[19] Some complaints do reach the Better Business Bureaus. See Statement of Harry Van Horn, President, Nat. Ass'n of Better Bureaus, *Hearing*, 73 *et seq*.

[19a] This organization is now entitled the National Association of Sales Finance Companies.

a membership of 201 companies, including the Big Three, representing a very substantial proportion of the automobile financing business of the nation, undertook the preparation of a code containing provisions designed to curb business-buying through excessive reserves, bonuses, and "packs."

The code which was finally formulated and submitted to the NRA represented, it was said,[20] a "compromise" between those employing the dealer reserve and those operating on the non-recourse plan. Paragraph (2) of Section 5 of Article VI ("Fair Trade Practices") prohibited the inclusion in any receivable arising from an automobile retail sale "of any amount for financing in excess of the amount deducted and/or retained for financing by" the finance company, and also prohibited the repayment "to the dealer or to any other party in any manner or form" of any part of the amount so "deducted and/or retained." Up to that point this provision would have eliminated dealer reserve, bonus, and "pack," but the concluding words "except as hereinafter provided in this section" paved the way for the preservation of the dealer reserve in the succeeding paragraphs which are set forth in full below:

"In transactions between the dealer and the [finance] company wherein the dealer assumes a definite and actual contractual liability (in the event of repossession of the motor vehicle from the sale or lease of which the receivable arose) by reason of repurchase agreement, or endorsement, or assignment and guaranty to the company in connection with the sale and assignment of such receivable to the company, involving the dealer's liability for loss and expense on the repossession, repurchase, and resale of such repossessed motor vehicle, repossession loss reserves may be credited by the company to the account of the dealer:

"(a) Such reserves shall be limited as follows: On new passenger car receivables, one and one half per cent (1½%) of the amount of the receivable; on used passenger car receivables, three per cent (3%) of the amount of the receivable with a minimum of $10.00 and a maximum of $25.00 on such used passenger car receivable;[21] and on each light delivery truck receivable, either new or used, an additional $5.00 may be credited.

"(b) Such reserves shall be accumulated without interest allowance to the credit of each dealer's account with the company up to a minimum of three per cent of such dealer's outstanding retail receivables, and shall so subsequently be maintained, any excess, as and when it may develop, to be paid to the dealer in the discretion of the company.

"(c) In all events repossession losses and expenses incident thereto of parent

[20] Statement of Robert P. Babcock, *supra* note 5, at 34.

[21] Author's note: In a substantial number of cases, the inclusion of these minima will result, of course, in a reserve much higher than the percentage indicated. The average amount of used car receivables reported to the Bureau of the Census for the year 1932 was $241. The $10 minimum represents slightly over 4 per cent on the average receivable. On cheap used cars it might equal 10 per cent or more. However, the proponents of the code state that the loss ratio on used car repossessions equals two and one half times that on new cars, Statement of Robert P. Babcock, *supra* note 5, at 44, whereas the percentage reserve for used cars is only twice that for new.

and/or affiliated and/or subsidiary companies shall be charged to the aforementioned repossession loss reserves before payment of such reserves to the dealer.

"(d) The Code Authority . . . shall at the request of any three companies inquire into the adequacy or inadequacy of such reserves in the locality affected and shall make such adjustments as may be necessary subject to the approval of the Administrator."

The proposed code containing the foregoing provisions was presented to a convention of the N. A. F. C. on September 23, 1933. It was carried by a vote of 82 to 22.[22] But soon after its adoption, the minority members girded their loins for battle. A regional association, the Mid-West Finance Conference, was promptly organized to voice the views of the dissenting groups. In the two weeks prior to the public hearing on the proposed code, the Conference mustered 357 objecting companies, including 38 companies which had attended the convention and either voted in favor of the code or abstained from voting. The volume of business handled by the 357 dissenting companies was estimated at "approximately $350,000,000."[23] Accordingly, the stage was set for a major battle when the code hearing convened in Washington on October 26, 1933.

The principal targets of attack were the provisions preserving the dealer reserve while abolishing the bonus paid under the non-recourse plan. The proponents of the code argued that the maximum rates in the code for dealer reserves were "substantially lower than the reserves [then] existing on recourse receivables" and that therefore those non-recourse companies which were already competing against higher dealer reserves without paying bonuses could continue to operate successfully under the lower code reserves.[24] The proponents pointed to the provision permitting sectional adjustments by the Code Authority, varying code rates, as affording a means of eliminating local inequalities.[25] They declared their adherence "to the principle that there is no justification for a bonus on receivables purchased without recourse and therefore without contractual liability, and that any provision for such a bonus would tend to unnecessarily increase the cost to the consumer."[26] In statements in behalf of the code from companies operating in the South[27] and on the Pacific Coast,[28] it was suggested that a 2 and 4 per cent reserve rate was needed; New England companies on the other hand regarded the 1½ and 3 per cent reserve as too high for that region.[29] All these groups looked, however, to the Code Authority to

[22] Statement of Robert P. Babcock, *supra* note 5, at 8. Owen L. Coon, representing the Mid-West Finance Conference, states the vote as having been 79 for, 25 against. *Hearing*, 82.

[23] The organization of the Mid-West Conference is described in the statement of Owen L. Coon, *supra* note 22, at 79-91. This conference developed into the American Finance Conference, a national organization operating independently of the N. A. F. C.

[24] Statement of Robert P. Babcock, *supra* note 5, at 44.

[25] *Id.* at 45.

[26] *Id.* at 48.

[27] Statement of W. D. Troyer, General Finance Co. of Louisiana, Inc., *Hearing*, 59.

[28] *Ibid.*

[29] Statement of D. W. Hinckley, *supra* note 16, at 63.

rectify the situation by sectional adjustments if experience indicated such adjustment to be necessary.

The burden of the argument on behalf of the objecting companies[30] was that dealer reserves were unnecessary,[31] that the reserves established in the proposed code were higher than the losses which the dealers would actually realize, that consequently the reserves in fact constituted a concealed rebate, and that the non-recourse companies, prohibited by the code from paying bonuses, would be at the mercy of their competitors which employed dealer reserves or would themselves be forced to operate under the repurchase plan. They asserted that sectional adjustments could be brought about too slowly to enable them to retain their dealer customers, and they questioned whether the provisions for sectional adjustments which were subject to the veto power of the Big Three[32] offered satisfactory prospects that such changes could be achieved.

Some of the speakers for objecting non-recourse companies conceded that they paid bonuses to dealers but insisted that they did so unwillingly. The reserve and bonus alike were repeatedly denounced as "commercial bribery," and solicitude was frequently voiced for the purchasing public.[33] Running throughout the statements of opposition speakers was a thread of hostility of "little business" toward "big business." The code, it was asserted, would "tend to promote a monopoly and discriminate against small enterprises."[34] It was urged that, if the dealer reserve were eliminated, then the recourse companies "could offer cheaper rates, and cheaper rates mean easier sales for the dealer. He could advertise those cheaper rates and sell more automobiles . . . and set up his own reserve, if he wants to, and derive much higher profit by increasing volume of business."[35] The preponderant minority view seemed in favor of the outright abolition of both reserve and bonus, but, under questioning by Deputy Administrator Whiteside who presided, one speaker conceded

[30] The objections to the code raised by the dissenting companies were reiterated so frequently in the course of the hearing that citations to individual statements do not seem useful. Criticism of the dealer reserve provisions extends from page 112 through page 180 of the record of the hearing and crops out occasionally in the discussion of other points.

[31] It was pointed out that the dealer reserve is not employed in the financing of instalment sales of other commodities.

[32] The Code Authority was to include ten members from the industry and one or more non-voting members appointed by the Administrator. Rules for their selection guaranteed a representation of three to the Big Three companies. Submitted Code for the Finance Company Industry, Art. VII, §1. (Hereinafter cited as the "Submitted Code.") Acts of the Code Authority required the concurrence of three-fourths of the members eligible to vote. *Id.* §9.

[33] This attitude was also expressed by proponents of the code. See, *e.g.*, Statement of Robert P. Babcock, *supra* note 5, at 29. Neither side carried this attitude to the extreme of devoting any consideration to the problem of statement of finance charges which was raised only in the proposals made by the representative of the Consumers' Advisory Board, Miss Constance Kent. The Board's proposals are set forth in Foster and Foster, *Rate Aspects of Instalment Legislation*, *supra*, at p. 193. For Miss Kent's statement, see *Hearings*, 97-99.

[34] Statement of Harry B. Dyer, *supra* note 9, at 165.

[35] Statement of Samuel Schleimer, Gotham Credit Corporation, *Hearing*, 168. He pointed out that his company operated in a used car field which was not invaded by the recourse companies, but insisted that if the independents were driven from the new car field they would be thrown into the used car business "and we will all be scrambling for the bones." *Id.* at 169.

that the basis of his objection was that the reserve percentage set was too high, not the existence of the reserve.[36]

The position of the proponents of the code in answer to the arguments of the dissenters is difficult to determine from an examination of the record of the hearings since no opportunity for rebuttal was afforded.[37] Incidentally, no representative of the Big Three spoke at the hearings. Some clue to the proponents' position may be derived from the charge circulated by the N. A. F. C. that "The objections to the code have been confined to those who prefer to continue to pay bonuses to dealers selling their paper on a without recourse basis."[38] This charge was repeatedly denied by representatives of the dissenting companies.

Deputy Administrator Whiteside who presided and who professed to be "totally ignorant of this business"[39] directed most of his inquiries to the questions of whether the dealer reserve subserved a useful function and of whether the gravamen of the dissent lay in the existence of the reserve or in the figure set in the code for it.[40]

Although other points of difference arose which will be discussed subsequently in this paper, the reserve and bonus problem seems to have been the rock on which this effort to establish a code split. Attempts by the NRA to bring the parties together in the months that followed were unsuccessful. In January, 1934, a code was proposed which included a provision designed to eliminate the "pack" but was silent as to reserve and bonus.[41] Although both groups were agreed on the desirability of abolishing the "pack," they were not ready to leave the problem of reserve and bonus undetermined. In May, 1934, the NRA submitted a proposed code to the industry which would have eliminated both bonus and reserve.[42] Needless to

[36] Statement of Paul Jones, President Mid-West Finance Conference, *Hearing*, 207. Mr. Jones is now president of the successor organization, the American Finance Conference, which is opposed to all reserves, regardless of the percentage.

[37] The procedure of code hearings precluded argument in rebuttal. Moreover, speakers were forbidden to controvert specifically statements made by prior speakers. See *Hearing*, 80.

[38] Quoted in Statement of Owen L. Coon, *supra* note 22, at 90.

[39] *Hearing*, 156. He is, however, an experienced credit man, having been President of Dun & Bradstreet, Inc.

[40] See, *passim*, *Hearing*, 150-161, 176-180. The explanation which is generally advanced in justification of the assumption by the finance companies of the burden which had formerly rested on the dealer, *i.e.*, the establishment of a reserve against losses, is that the dealer, selling an article at a price publicly advertised by the manufacturer on credit terms established by the finance company, is not in a position to increase either the price or the finance charge to take care of risks of loss incidental to reselling. The reserve is asserted to be substantially similar to, although perhaps smaller than, that which a non-recourse company would have to set up for its own protection.

[41] The provision reads as follows: "Art. VII. Fair Trade Practices—Automobile Financing. Section 3. Misrepresentation. No company shall purchase or otherwise acquire any receivable . . . (b) wherein the dealer has added to the selling price to the customer in constructing the time price any amount in excess of the differential fixed by the company in its chart in the hands of the dealer; provided that this subsection (b) shall not apply to bulk purchases of receivables which the dealer has carried in his own portfolio for a longer period than ninety (90) days, if not so carried in contemplation of avoiding the spirit and interest of this section or to receivables or trucks selling for more than $1500."

[42] Section 5 (a) of the article dealing with Fair Trade Practices contains a general prohibition against the giving of bonuses or other gratuities to dealers by finance companies. Paragraph (b), directed to the reserve, provides as follows: "No company shall in connection with the purchase of a receivable, set up any reserve for the purpose of creating a credit for a dealer. Any money held on the effective date of

say, this proposal did not prove acceptable to the Big Three. More surprising, however, it was not endorsed by the dissenting independents who were not satisfied by the composition of the Code Authority or the "factory coercion" clause which will be discussed in a succeeding section.

Again, in July, 1934, the NRA returned to its January proposal designed to eliminate the "pack" but to leave the dealer reserve and bonus subject to future regulation.[43] The Code Authority was authorized, upon concurrence of three-quarters of the companies "both numerically and by volume of business," to recommend "further fair trade practice provisions" to the Administrator for inclusion in the code.[44] Possibly the existence of this power or the statutory power of the President to modify his approval of the code[45] rendered the antagonists reluctant to come under a code while the principal point of difference between them remained unsettled. Moreover, by this time, other provisions in the code had assumed a greater importance, as will be seen below, and the problem of effecting a satisfactory compromise had grown more formidable.

Not long after there emanated from the American (*née* Mid-West) Finance Conference a proposed code, dubbed by its sponsors the "Workable Code." The "Workable Code" included a provision for the elimination of the "pack" similar to that contained in the Administration's proposal,[46] and then met the problem of the reserve and bonus by a provision authorizing both, but setting a maximum limit of 2 per cent of the unpaid balance in the case of new car paper and 4 per cent in the case of used car paper.[47] This solution seems to have been unacceptable to the Big Three and also to the Administration which was reluctant to sanction the payment of any bonus for which no service was rendered.[48] The "Workable Code," however, was approved by 251 companies.[49]

To an observer who is enrolled in neither camp, one fact seems evident, namely, the lack of facts, facts sufficiently comprehensive and sufficiently authoritative to serve as the basis of judgment. A number of representatives of the dissenting companies

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this code by a company on behalf of a dealer arising from the purchase of a receivable shall be returned to such dealer within ninety (90) days of the effective date of this code."

[43] For the relevant provision, see note 41, *supra*.

[44] Code proposed by NRA, July, 1934, Art. VI, §6 (b).

[45] NIRA, Tit. I, §10 b, 48 STAT. 200 (1933), 15 U. S. C. A. (Supp. 1934) §710 (b).

[46] "Workable Code," Art. VII, §3 (b). This provision follows in substance the language of paragraph (b) in the Administration code, *supra* note 41, up to the proviso.

[47] "Workable Code," Art. VII, §3 (c). "Section 3. Misrepresentation. No company shall purchase or otherwise acquire any receivable . . . (c) wherein the dealer and/or anyone connected therewith shall participate in the finance charge in any transaction directly or indirectly in an amount in excess of 2% of the unpaid balance (cash delivery price less down payment) on new car paper and in excess of 4% of the unpaid balance (cash delivery price less down payment) on used car paper."

[48] Dealers operating under a non-recourse plan often do render some services to the finance company both in the collection of accounts and in the disposal of repossessed cars. They are not under obligation to perform these services, however, nor is the amount of the bonus measured with reference to their extent.

[49] 19 companies dissented. 204 companies did not indicate their position. AM. FINANCE CONFERENCE, THE BUSINESS OF AUTOMOBILE FINANCING (1934) 15.

offered evidence to show that, operating under the non-recourse plan where their liability was not limited as is the dealer's who operates under a repurchase agreement, their losses ran substantially below the reserves against dealer's limited losses.[50] But how representative the losses sustained by those companies are of the experience of dealers generally is difficult to tell. They may represent the effect of greater care in the selection of credit risks than finance companies operating with manufacturer affiliations are in a position to make. They may reflect a selection of dealers whose operating experience is better than average. Again, since most of the loss ratios offered were based on periods of time extending back to the New Era of blessed memory, they may not be representative of credit experience under the depression and the New Deal. Before a definitive appraisal could be made of the submitted code's dealer reserve provisions on the score of their fairness as between the competing branches of the industry, it would seem essential that an extensive survey of loss ratios be undertaken by an impartial agency, preferably the Research and Planning Board of NRA.

It must be conceded, however, that the problem is one which accuracy in fact-finding alone cannot solve. It is certain that any such survey would reveal significant variations in loss ratios from region to region throughout the nation and from dealer to dealer within each region. Even if regional reserve rates were established, the efficient dealer whose losses ran below the regional average would find in the reserve a source of profit. If reserves were abolished but finance companies undertook to reimburse dealers for their actual losses, the inefficient or careless dealer, whose business today non-recourse companies properly refuse to carry, would in effect receive a subsidy which would have to be reflected in the finance charges of companies operating nationally. A possible escape from this dilemma might be for such companies to reimburse actual dealer losses but not in excess of the regional average loss ratio.[50a]

THE CONSUMER'S INTEREST IN THE RESERVE-BONUS ISSUE

But the consumer is a party in interest to this controversy, as both sides have freely admitted. What is his stake in the controversy? Certainly it is apparent that the existing situation operates to his disadvantage.[51] In some instances where com-

[50] One loss ratio ran as low as .32 per cent on a ten year average. Statement of D. B. Cassatt, *supra* note 18, at 133. One statement based on an analysis of 150 companies prepared for the N. A. F. C. indicated a loss ratio of .86 per cent. Statement of Harry Weiss, *supra* note 12, at 120. Mr. Weiss quoted from a bulletin issued by one of the Big Three to dealers in which the dealer reserve feature of this company's plan was stated to have been a source of profit to dealers prior to 1930. The reserve percentages were the same as those in the submitted code.

[50a] A set-up of this sort would seem permissible under a code forbidding both dealer reserves and bonuses since the suggested reimbursement of dealer losses amounts to in substance to the adoption of the non-recourse plan of operation, adapted to the needs of finance companies which must serve varying types of dealers.

[51] "The importance of the elimination of this evil can be understood when we are advised that the amount that was taxed the purchasers of automobiles during the year 1933 was between $40,000,000.00 and $60,000,000.00." AM. FINANCE CONFERENCE, *op. cit. supra* note 49, at 20. It is not entirely clear whether this estimate is confined to dealer reserves or includes bonuses and "packs."

petition was acute, the field of competition seems to have been removed from that of service to the purchaser to that of compensation to the dealer. It was asserted in the course of the hearing that with the introduction of the dealer reserve and the retaliatory bonus, the trend toward lower finance charges which had been in process theretofore came to an end and that thereafter economies in financing operations were reflected, not in lower finance charges to the car purchaser, but in larger payments by the finance companies to the dealer.[52] More recently, the tendency has been to lower the charge to the purchaser.

However, before it is assumed that these practices, including even the notorious "pack," represented entirely an unjust exaction from the consumer, another question must be answered: did the increase in the dealer's compensation through repayments out of finance charges represent more than a fair offset to the reduction in the dealer's compensation as seller of the car? The dealer is entitled to a fair return for the services he performs. In the depression period, when car prices and volume of sales were falling, the dealer's profit on sales fell with them. Moreover, since a buyer's market prevailed, he was obliged to make trade-in allowances which cut into this narrowed profit-margin. Loss ratios were higher. Beset by these difficulties, it seems likely that many dealers would have gone to the wall if they had not derived an additional income from dealer reserves, bonuses, and "packs." Yet while the effect of these practices may have been to assure to the dealer no more than a fair reward for his services, they operated to distribute the burden of contributing to his income unfairly as between his cash and credit customers. The latter in effect subsidized the former.

Whatever the force of this argument may have been before the adoption of the Code for the Motor Vehicle Retailing Trade, the effect of the operation of that code in tending to stabilize trade-in allowances[53] has been to weaken it appreciably. The dealer today, with better assurance of a fair profit on his sale transaction, has less claim to an added increment through the financing charge.[54] This relationship of dealer compensation to the problem of finance company practices points, moreover, to a basic difficulty inherent in seeking the solution to that problem through the code of a single industry. In addition to the consumer, there are three parties in

[52] Statement of Milton Epstein, Wisconsin Ass'n of Finance Companies, *Hearing*, 143. Mr. Epstein was speaking on the basis of his own company's experience. Information as to the cost of instalment financing to the consumer is difficult to obtain. See Froman, *The Cost of Installment Buying* (1933) 11 HARV. BUS. REV. 227.

[53] See Code for the Motor Vehicle Retailing Trade, Art. IV, A. The only provision in that code relating to finance charges is the following: "Charges for financing retail conditional sales shall be upon an equitable basis to consumer and dealer. No dealer in financing conditional retail sales shall charge a lower rate than the lowest or a higher rate than the highest rate charged by regularly established finance companies operating in the same district as the dealer," *Id.*, Art. IV, B (3). It would seem that this provision operates only where the dealer himself finances retail sales and that therefore it would not prevent the "pack" since the "pack" is merged in the finance charge.

[54] It is asserted, however, that gains under the code have been largely offset by reductions in the profit-margin on new car sales allowed by manufacturers to dealers. See *Am. Finance Conf. News*, Feb. 19, 1935.

interest to the retail sale[55] of an automobile, the dealer, the finance company, and the manufacturer. A Code of Fair Competition for any one of these industries, drafted as it must be by the members of that industry and imposing its sanctions upon them only, must perforce deal with the problem in piece-meal fashion. And when all three industries have thus made their individual contributions to the problem, it is not to be wondered at if they do not dovetail perfectly.

Moreover, even if there were not this piece-meal treatment of a problem affecting an integrated economic process, one might still question whether any code structure, in the formulation of which the consumer's interests were relegated to secondary position, could be expected to function satisfactorily. The abuses of the reserve, bonus, and "pack" were made possible only because of the utter want of intelligent consumer interest in financing charges. The automobile purchaser responds promptly to variations in the f.o.b. price of competing makes of cars; he approximates the horse-trader in the matter of trade-in allowances; but he has been as gullible as a child when confronted by a finance charge. Perhaps there is still some psychological impediment to self-assertion on the part of one who must ask for credit, routinized as that transaction has become. But however that may be, it is evident that an aggressive campaign on the part of finance companies stressing lower credit costs would have overcome any such inhibition. The failure on the part of the industry to adopt this tactic has all but nullified the effectiveness which the consumer might have had as an ally in the enforcement of code provisions designed to overcome those abuses which victimize the purchasing public as well as disrupt the industry. One may doubt, indeed, whether, if the proposed code had been adopted, it would have proved enforceable unless, either through additional code requirements or through a change in competitive policies, the companies had aroused the car purchaser's interest in financing costs and thereby enlisted his aid in stamping out over-charging.

PROPOSALS FOR CODE REGULATION OF CREDIT TERMS

The other code provisions about which debate centered had little bearing on the consumer's relation to this problem. The submitted code contained no specific provisions governing either the method of stating or the amount of the credit charge, allowance for prepayments, or the exercise of the finance company's legal remedies. One provision[56] was directed at dealer misrepresentation, prohibiting the purchase of "any receivable arising from a retail sale or lease of any passenger automobile or light delivery truck wherein, to the knowledge of the company, the terms and conditions of the transaction have been misrepresented." (Heavy duty trucks are seldom financed under the ordinary plans; hence, apparently, their exception.) Two grants

[55] The problem of financing wholesale transactions has not been considered in this paper. It is evident, however, from the inclusion in the submitted code (Art. VI, §2) of a prohibition against wholesale financing below cost, that the dealer has occupied a favored position in this respect. Unduly low wholesale rates must be reflected in higher retail rates.

[56] Submitted Code, Art. VI, §5 (1).

of power were accorded the Code Authority to deal with other abuses. Section 1 of Article VI ("Fair Trade Practices") provided as follows:

"Retail Credit Terms. Retail credit terms involved in receivables acquired by companies shall be subject to regulation by the Code Authority . . . with respect to any problems, sectional or otherwise, which exist or may arise from time to time."

Section 6 of the same article was even more general. It read:

"Other Business Practices. Various practices which are not herein specifically defined and the practices herein referred to, to the extent that problems with respect thereto may arise which are peculiar to certain sections or circumstances, shall be referred to the Code Authority . . . whose duty it shall be to regulate them in a manner equitable to all concerned, subject to approval by the Administrator."

Except for a protest against Section 1 filed by the National Retail Dry Goods Association,[57] these sections and the problems blanketed by them escaped discussion. Despite their sweeping terms, their potentialities were straitly limited by the requirement of a three-fourths vote as a prerequisite to Code Authority action.[58]

The codes proposed by the NRA went somewhat farther in this direction, except that their fair trade practice provisions were limited to automobile financing. The provision against misrepresentation, substantially the same as that quoted above, did not exclude any type of car.[59] A provision in the code proposed in July, 1934, struck at the use by dealers of more than one rate chart for each make of car.[60] These codes required receivables purchased by finance companies to carry on their face or on an accompanying memorandum the following information "set out in the manner and form indicated below":[61]

"(a) Cash delivery price including extra equipment .... $..............
"(b) Time delivery price .... $..............
"(c) Down payment .... $..............
"(d) Balance due .... $..............
"(e) Number of instalments, amount of each and due date thereof .. $..............
"(f) Nature of insurance coverage, if any .... $..............

"A true and correct copy of the data as given above has been given to the purchaser or lessee in the transaction above referred to.

"Signed.."

These codes also dealt with the matter of pre-payments, providing for an allowance, on *bona fide* offers to pay the unpaid balance, of "not less than six per cent

[57] This Association objected to this regulation of retail credit terms as potentially impairing the competitive position of retail dry goods merchants resorting to finance companies as against those who did their own financing. It also broadly attacked this section as an unjustifiable limitation on individual initiative and vewed with alarm the perils to "the consuming public" arising from such control. Statement of Irving C. Fox, Nat. Retail Dry Goods Ass'n, *Hearing*, 107-109.

[58] Submitted Code, Art. VIII, §9.

[59] Code proposed by NRA, July, 1934, Art. VII, §3 (a). Earlier proposals contained a similar provision.

[60] *Id.* §3 (c).

[61] *Id.* §5.

per annum on the total amount to be paid on each individual payment, computed for the number of days by which such payment is prepaid."[62]

The "Workable Code" contained provisions substantially similar to those appearing in the Administration codes on these points.[63]

PROPOSALS FOR CODE REGULATION OF "FACTORY COERCION" AND "SUBSIDIES"

The questions other than the dealer reserve and bonus problems which did excite controversy, at the hearing and thereafter, related chiefly to the composition of the Code Authority, "factory coercion," and "factory subsidies." A consideration of the first of these questions is without the scope of this paper; as one might surmise, it reflected the divergence in interests between the Big Three and the independents. The other questions must be dealt with briefly.

"Factory coercion" is the exercise of coercive pressure by a manufacturer upon a dealer to dispose of his receivables to a finance company owned by or affiliated with the manufacturer. Although denying that such coercion existed,[64] the Big Three who alone might be its beneficiaries acquiesced in the insertion of the following provision in the submitted code:

"Factory Coercion. No company shall permit or sanction any solicitation of business whereby the dealer is required under threat, direct or indirect, to dispose of his receivables to such company."[65]

Representatives of dissenting companies insisted that coercion did exist in the industry and made plain their belief that the code provision was toothless.[66] In proposing alternative provisions, however, some difficulty was encountered in the fact that coercion relates to dealer-manufacturer relationships whereas the code could extend its sanctions only to finance companies.[67] Deputy Whiteside, moreover, pointed to the difficulty of controlling a practice so "intangible" in character[68] and termed "very good" the provision in the submitted code. "You will find," he added,[69] "if you ask attorneys about it, that it is quite difficult to make one any stiffer, because we tried to do it."

Two of the Administration's codes repeated the original provision; the May, 1934, proposal added a reinforcing clause.[70] However, the "Workable Code" drafted by

[62] *Id.* §6.

[63] "Workable Code," Art. VII, §3 (a) (misrepresentation), §5 (credit terms), §6 (pre-payment allowance). No restriction to the use of one rate chart was included.

[64] Statement of Robert P. Babcock, *supra* note 5, at 31.

[65] Submitted Code, Art. VI, §3.

[66] The statements of G. A. Pivirotto, Automobile Finance Co., Pittsburgh, Pa., Lew Fleming of the Associates Investment Co., South Bend, Ind., and Abraham Cooper, Union Investment Co., Detroit, Mich., were addressed to the question of coercion. See *Hearing*, 180-191.

[67] See *Hearing*, 185.

[68] *Id.* at 186.

[69] *Id.* at 187.

[70] The new clause which was added to the coercion provision set forth in the text, *supra*, read as follows: "nor shall any company accept or acquire any receivables where the dealer, to the knowledge of the company, has been required, under threat or force, direct or indirect, on the part of any automobile manufacturer to dispose of such receivables to such company."

the independents emerged with a much more elaborate and formidable interdiction. Its rigorous tenor can be indicated by the last two of the five sentences comprising it.

"*Coercion.* . . . No finance company shall purchase any receivables from any dealer where any coercion or demand, either direct or indirect, has been made in its behalf, with the knowledge of the finance company, compelling or requiring or inducing the automobile dealer to transact his business with or dispose of his receivables to such finance company. Any factory owned or factory affiliated company shall be presumed to have knowledge of any and all acts of its affiliate or of the company by which it is owned."[71]

The Big Three, needless to say, did not find this provision "workable." Although they denied the existence of coercion, they pointed to the risk of harassing complaints by the independents which their very numbers and the indefinable character of coercive action would make probable. In an effort to meet this objection which had also been raised with respect to the NRA's own provision, the NRA had undertaken the preparation of a provision contemplating the imposition of a penalty for the bringing of complaints without probable cause when further code negotiations were suspended in the fall of 1934.

From the standpoint of the consumer, the harmfulness of coercion, if it exists, would lie in the fact that it constitutes a competitive practice bringing no direct benefit to him and thereby depriving him of the fruits of normal competition. But, as has been seen, these fruits have not thus far been abundant. Moreover, so long as competition between manufacturers persists, it is not clear that a monopolization of the financing business by their affiliates would necessarily be detrimental to automobile purchasers. The problem of factory coercion does not, therefore, seem to be of primary importance from the consumer standpoint, however significant it may be to the dealer and independent finance company.

"Factory subsidies" are payments made by a manufacturer to finance companies to enable them to reduce charges for financing the former's products. Apparently such subsidies were at one time paid by automobile manufacturers, but it was generally agreed at the code hearing that the practice had been discontinued.[72] No prohibition of such subsidies was contained in the submitted code, and Deputy Administrator Whiteside took the position that its inclusion was undesirable so long as the practice was not subsisting. He suggested that if the practice were to recommence, the Code Authority could make "ample provision for that."[72a] This did not serve to quiet the demand for the interdiction of the subsidy, however, and the

[71] "Workable Code," Art. VII, §4.

[72] See Statements of John E. Davis, National Guaranty Finance Co., *Hearing*, 195, Lew Fleming, *id.* at 197. The speaker dissented from this view. Statement of Harry B. Dyer, *supra* note 9, at 198. A provision prohibiting subsidies was successfully opposed by a representative of one of the Big Three companies when it was proposed for inclusion in the submitted code. He expressed fear that some manufacturer would bring out a "low rate finance plan" to meet which it would be necessary for his company to receive a subsidy. See AM. FINANCE CONFERENCE, *op. cit. supra* note 49, at 31.

[72a] *Hearing*, 196.

"Workable Code" included a provision[73] prohibiting subsidies unless recorded with the Administrator and available to all finance companies.

The time purchaser, of course, benefits directly from the subsidy. Whether this benefit is at the expense of the cash purchaser depends on whether it enables a manufacturer to expand his market sufficiently to permit a reduction in, or at least to maintain, the cash price. Except where the subsidy is employed to induce the financing of a new product which finance companies are otherwise unwilling to handle, it gives the recipient a great competitive advantage. Its indirect consequences to the consumer depend, accordingly, upon the importance of maintaining the independent finance companies as a competitive factor in the industry.

The prevailing uncertainty as to the future of the NRA renders difficult prediction as to the future of efforts to regulate competitive practices in the finance company industry by a code of fair competition. Certainly the obstacles encountered in the formulation of a code for this industry at a time when the Blue Eagle flew high in the land renders the prognosis extremely unfavorable. But the effort to subject finance company practices to code regulation has served to bring the issues dividing the industry into the open. As a consequence, the abuses thus disclosed are less likely to persist. What the reforming forces will be is matter for conjecture, but it seems not improbable that they will include the following: (1) Voluntary efforts on the part of the industry to curtail rebating to dealers.[74] (2) A growing interest on the part of automobile purchasers in the cost of financing. (3) Competition among finance companies in the offering of lower financing charges to the public.[75] (4) Regulatory state legislation of instalment sale credit terms and competitive practices.[76] An early application of the first three forces might render the last superfluous.

[73] "Workable Code," Art. VII, §7.

[74] A measure which should operate to diminish the dealer's opportunity to add a "pack" to the finance charge is illustrated in a bulletin issued by the Chrysler Corporation to all De Soto dealers: "The new Dealer franchise for 1935 will carry a proviso that Chrysler Motors products sold to the public on a time payment plan basis shall not carry a larger financing charge than the charge set forth in the official Chrysler Motors Commercial Credit Company's plan for the territory and that time buyers be furnished the insurance cover provided by said plan." Quoted in AM. FINANCE CONFERENCE, *op. cit. supra* note 49, at 29, which sets forth the bulletin as evidencing factory coercion. It is believed that other manufacturers affiliated with the Big Three have adopted similar franchise conditions.

[75] That greater efforts to arouse consumer interest in finance charges may be anticipated in the future is suggested by a national newspaper advertising campaign undertaken this winter by G. M. A. C. in which the public was urged to employ a chart provided in the advertising to check "costs and other differences in time payment plans." "If there is a difference, you should know it."

[76] Since the completion of this article, I have received a copy of the Indiana Retail Installment Sales Act, Ind. Acts 1935, H. B. 377, which establishes a licensing system for sales finance companies doing business in that state, to be administered by the Department of Financial Institutions. The Act, which constitutes the first far-reaching attempt to regulate this business, is too long for complete summarization in this paper. Its principal provisions with respect to rates are set forth in Foster and Foster, *Rate Aspects of Instalment Legislation, supra*, at p. 194. Especially revelant to the issues on which the code controversy focussed are the sections summarized below: *Section 9*. No dealer may assign any retail contract to any person other than a licensee. *Section 10*. No part of the finance charge may be repaid by the finance company to the dealer in excess of an amount to be fixed by the Department and this maximum is to be fixed "without regard to any differentiation as to whether" the contract is assigned on the recourse, non-

recourse, or repurchase plan. *Section 21.* Conditions in sales by a manufacturer to a dealer that the dealer shall assign his retail contracts only to designated licensees are declared unlawful when their effect "may be to lessen or eliminate competition." *Section 22.* "Any threat, express or implied, made directly or indirectly" by a manufacturer to a dealer to discontinue sales to the latter unless he assigns his retail contracts to a designated licensee shall be "prima facie evidence" of a condition prohibited by Section 21. *Section 23.* Any similar threat by a licensee affiliated with a manufacturer shall be presumed to be at the direction of the latter and shall be prima facie evidence of an illegal condition. *Section 24.* Subsidies by manufacturers to licensees are prohibited if their effect "may be to lessen or eliminate competition."

The resemblance between these provisions and those of the "Workable Code" is marked, and the Act obviously represents a legislative victory for the independents. The Act burgeons with constitutional problems, and it seems safe to predict that it will not long go untested.

THE MECHANICS OF THE INSTALMENT CREDIT SALE

M. WILLIAM ADELSON*

The modern instalment credit sale may be justly compared to an intricate piece of machinery. Its legal structure is composed in part of legal rules, in part of contractual provisions. But a study of the machine's design will not suffice to reveal its everyday operation, for legal devices contain many tools intended only for emergency use. For an understanding of the operation of the mechanism which has been created for instalment sale credit, it is necessary to examine it with reference to the business practices which have developed in its employment. This article, accordingly, seeks to depict not only the legal structure of the instalment credit sale but also its operation, chiefly as it is revealed in the retail sale of automobiles.[1] The diversity in both the fields of law and practice[2] is such that generalization has been compelled, with the consequent sacrifice of those qualifications essential to complete accuracy. Detailed portrayal, however, would require a corpulent treatise.

Instalment selling in the average retail sale where the seller himself assumes the burden of carrying the credit is characterized by relatively simple agreements[3] usually

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[1] The retailing of automobiles has been selected in part because the volume of automobile sales on instalment credit constitutes, it has been estimated, over 50 per cent of all retail instalment sales, Lynd, *The People as Consumers*, 2 RECENT SOCIAL TRENDS (1933) 857, 862, and in part because the legal mechanism seems to have been most completely developed in this field. Concentration on the normal automobile transaction has eliminated the consideration of those abuses which are encountered most frequently in the sale of other commodities. For a discussion of sharp practices encountered in instalment credit sales, see Greene, *Better Business Bureau Activities in Aid of the Time Purchaser*, *infra*, p. 254.

Considerations of space have precluded a treatment of the credit mechanism created for automobile wholesaling.

[2] A business national in scope will undoubtedly reveal variation in practices not only from region to region but also from company to company. As representative of the contracts of the standard, reputable finance company, contracts used by the four national companies, Commercial Credit Company, Commercial Invest Trust, Inc., General Motors Acceptance Corporation, and Universal Credit Company, have been selected for study. Although one set of contracts covering the nation was secured, most of those examined were prepared for use in North Carolina and adjacent states. Study of the contracts was supplemented by interviews with dealers and finance company representatives and reference to the works hereinafter cited.

[3] These more simply phrased contracts, as used by companies doing their own financing to a large extent, such as Montgomery Ward and Sears, Roebuck, have apparently proved to be about as effective for their purposes as the more elaborate finance company contract. The smaller sums usually involved,

designated as "Easy Payment Plan," "Ten Payment Plan," "Nu-Way Credit," or merely "Conditional Sale Contract." These contracts do little more than provide for retention of title in the seller with a stipulation reciting that a down payment of a certain amount has been made on the purchase, with remainder of the price to be paid in monthly or weekly instalments generally ranging from 25 cents to ten dollars. But a rise in the amount of the credit extended presents a problem of financing for seller as well as purchaser and leads to the employment of more elaborate credit instruments, as is best evidenced in the retail sale and financing of automobiles. The large capital necessary for extensive financing in this field necessitates a selling of the purchaser's debt to someone who will pay the dealer cash and continue unaltered the credit extended to the purchaser. To meet this need, a new business institution has been developed, the sales finance company. For its operations, the finance company requires the embodiment of the car purchaser's debt in a negotiable note which may be readily discounted and rediscounted and which may be enforced with a minimum of inconvenience. The sale of a debt which is evidenced merely by a simple contract of sale and title-retaining instrument is difficult, for a non-negotiable contract of this character presents an enhanced credit risk and is one of the least acceptable forms of commercial paper.

The finance company could not long have survived had it relied on the initiative and ingenuity of the local dealer and his counsel to supply appropriate credit instruments and information. Consequently, it is the finance company which not only normally determines the credit terms to be extended to the purchaser but also supplies the credit instruments and personal information forms embodying his obligation and revealing his credit reputation.

Today the purchaser of an automobile on the instalment plan, after agreeing on terms[4] and filling out a "purchaser's statement,"[5] signs an elaborate contract providing for retention of title to the car in the seller and setting forth in full the obligation of the buyer to pay. There are additional stipulations as to conditions of the buyer's use of the car and rights of the seller upon default by the buyer in payment of the price or non-observance of the conditions. Attached to or accompanying this contract

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together with the willingness to make extensions, may in part account for the relative infrequency of appearance of these two companies in appellate courts.

[4] The ordinary practice is to sell new cars for one-third down payment with the remainder payable in twelve months, eighteen being the limit. On used cars, minimum down payments are around forty per cent of the total price, with balance payable at the longest in twelve months, since experience has shown that the used car buyer and the used car itself present a greater financing risk. GOLIEB, CREDIT AND COLLECTIONS (1931) 69. For school teachers, farmers, and others with periodic incomes, plans deferring payment during the non-income months are arranged.

[5] The back of the original copy of the contract bears a form questionnaire for information relative to the purchaser's background, earning power, and general financial standing. The experience of the merchants who have extended credit to the purchaser, as revealed through credit bureaus, coupled with the nature and stability of the purchaser's employment, in large measure determine acceptance or rejection as a credit risk. In doubtful cases, careful personal investigation is made by a company representative. Credit men reiterate that the main question is, "Can he and will he pay?" See, in general, GRIMES, FINANCING AUTOMOBILE SALES (1926) 42.

is a promissory negotiable note, which is signed by the purchaser as maker and indorsed on the back of the dealer, either with or without recourse, depending on the nature of his agreement with the finance company. This note, accompanied by an assignment of the conditional sales contract, is then sent to the finance company for purchase.

THE DEALER AND FINANCE COMPANY

If the finance company, after an investigation of the credit risk entailed, decides to purchase the note and contract offered it, the company will remit[6] to the dealer an amount equal to the difference between the cash selling price of the car and the down payment which he has retained. The remainder of the sum due on the note represents the financing charge.[7] To what extent the dealer then steps out of the picture rests wholly on which one of the three types of finance agreements he is working under—recourse, non-recourse, or repurchase.[8] An examination of these types of dealer-finance company relationships is an essential preliminary to the consideration of the operation of the purchaser's contract.

1. The Recourse Plan

The dealer indorses the note with recourse, and if the purchaser fails to pay, the dealer is liable on the note for the balance due. In the early days of large scale instalment financing this was the practically universal requirement. Today it has virtually disappeared in automobile financing, except in the few cases where a bank or small loan company extends the credit.[9] The insistent demand by the dealers for relief from the constant menace to their liquidity arising out of their contingent liability in the event of default by the buyer or of loss or destruction of the car, led to the advancement of two other plans of financing, the non-recourse indorsement and the repurchase plan.

However, the finance companies do insist on indorsement with recourse in the financing of domestic appliances, *e.g.*, refrigerators, oil burners, electric stoves, vacuum

[6] Generally the finance company must accept or reject the paper within 20 days. According to the financial standing and general reputation of the dealer for selecting good credit risks, the dealer is either paid by draft on the finance company as soon as the paper is mailed to it, or by check after the paper has been accepted. In the former case, the dealer agrees either to repurchase or indorse with recourse all paper which is rejected as below the credit requirement.

[7] Some companies remit a portion of this charge to the dealer as a reserve against losses or as a bonus. The controversy which has arisen as to these practices is discussed in Cavers, *The Consumer's Stake in the Finance Company Code Controversy*, *supra*, p. 200, at p. 204.

[8] For a discussion of these plans, see 1 SELIGMAN, ECONOMICS OF INSTALMENT SELLING (1927) 75 *et seq.*

[9] It is not to be supposed that the sales finance companies have entirely taken over the financing function. Some dealers do their own financing, especially in the case of used cars selling for $150 or less. In other cases where the finance company rejects the paper, or the buyer desires longer terms, smaller down payments, or lower finance charges, the dealer sometimes discounts at a bank. As Seligman points out, the experience of bankers with this type of paper varies, and there is a conflict of opinion among bankers themselves as to its soundness and advisability. 2 SELIGMAN, *op. cit. supra* note 8, at 406. Whether or not the car is used as security, the dealer generally assumes the burden of collecting for the bank. There is always the consideration that too much business may be disastrous to the dealer indorsing with recourse, when either the exhaustion of his credit line or a series of defaults leaves him without available funds for continuing his business. See LORENZ & MOTT-SMITH, FINANCIAL PROBLEMS OF INSTALMENT SELLING (1931) c. 1.

cleaners, etc.[10] The reason for the difference in indorsements may be readily explained. The dealer is more willing to indorse with recourse on appliance sales, since depreciation is relatively small and the danger of loss through removal or default about half the ratio for automobiles.[11] The finance companies' insistence is due to the burden of invading the housewife's kitchen and providing apparatus for removing and transporting the machine, a practical problem for which dealers are much better equipped than the finance company. In contrast the automobile is its own mode of transport and can usually be repossessed on the streets.

2. *The Non-Recourse Plan*

The dealer indorses the note without recourse. This method, first adopted by smaller finance companies to attract business from the larger ones, and as used more recently by the larger companies, is based in the main on the established business standing of the purchaser and dealer. The general policy is to reject all paper which is not an A-1 risk[12] unless the dealer sees fit to enter a more complete guaranty agreement which is acceptable to the finance company.[13] In the usual case, the dealer's responsibility has ended with the purchase of the paper by the finance company, but there are occasionally situations when he will still have to make good the balance on warranties of the note or contract. Under his "recommendation, assignment and guaranty" which he has signed as part of the contract, the dealer usually agrees to be liable if title to the car is encumbered at the time of sale of the paper to the finance company, if the property is not as represented in the contract, or if he knew that statements made in the purchaser's statement were untrue. Further warranties in some of the contracts are to the effect that "the cash payment has been received and/or the trade in allowance is correct," and that all parties have capacity to contract.[14]

3. *The Repurchase Plan*[15]

The dealer indorses without recourse with a contract covering all transactions in

[10] A negligible number of repurchase agreements exist even in this financing. The dealer is usually prevailed upon to repossess.

[11] In new car sales for 1932, it was estimated that the ratio of defaults to the entire number sold on instalments was 4.5 per cent, while for domestic appliances it was 2 per cent. *The Anticipated Dollar* (Jan. 1933) 7 FORTUNE 68.

[12] On the basis of the credit investigation (see note 5, *supra*), the purchaser is classified in one of three credit categories, *e. g.*, "Very Good," "Fair," and "Poor," designated by letter or numerical symbol.

[13] Unlike the practice in the sale of paper subject to repurchase, the finance company alone investigates the purchaser in the non-recourse transaction. However, if the dealer evidences symptoms of becoming a mere order-taker, without regard to the purchaser's ability to pay the price, finance companies will avoid transactions to which he has been a party, or subject his paper to an even more rigid scrutiny.

[14] Practically the same warranties attach to the dealer's non-recourse indorsement of the note. NEGOTIABLE INSTRUMENTS LAW, §65. The guaranty is absolute so that, even if the purchaser misrepresents his capacity to contract, the dealer is liable. Comm. Credit Co. v. Ward Auto Co., 215 Ala. 34, 109 So. 574 (1926). Instead of a suit for breach of warranty there may be rescission and an action for the consideration paid the dealer. Comm. Credit Co. v. Third & Lafayette Sts. Garage, 226 App. Div. 235, 234 N. Y. Supp. 463 (1929).

[15] Although usually the details of repurchase agreements are kept as private information, occasionally their importance in determining the legal rights of the dealer and finance company necessitates full disclosure in litigation. See Comm. Credit Co. v. Insular Motor Co., 17 F. (2d) 897 (C. C. A. 1st, 1927); C. I. T. Corp. v. Anderson, 165 Wash. 603, 5 P. (2d) 990 (1931).

which he agrees to repurchase repossessed cars,[16] or he indorses with recourse with an agreement[17] providing that his endorsement shall not be enforced unless the car is returned. These so-called repurchase agreements constitute the means devised by the larger companies to meet the objections raised by dealers to the severity of the recourse plan. Most of their business is now conducted under such agreements, and although for reasons of competition they are obliged to handle non-recourse paper on occasion, they strongly discourage the use of the plan.

The repurchase plan provides protection against conversion or confiscation risks, since the dealer's liability arises only if the car is returned within ninety days after default. Since wreckage loss may be equally great, collision coverage is also provided. The protection accorded by this plan is for the benefit of the dealer only.[18] The collision provision usually allows a deduction for the amount of repairs necessary or provides for repair by the finance company. It would seem that the larger finance companies usually act as their own insurers in furnishing protection against these risks to the dealer.

As a practical matter, regardless of the plan employed, the dealer and finance company are rarely found in opposition to each other in the courts. Mutual dependence and explicitness of their agreements is the probable explanation.

The contract and note having been sold to the finance company, consideration must now be turned to the position of the finance company as successor[19] to the dealer's rights against that temporarily forgotten man, the purchaser. This requires an examination of the instruments employed to create and secure his obligation.

THE CREDIT INSTRUMENTS

A. THE PROMISSORY NOTE

As has been seen, the purchaser's contract is divided into two parts, the contract of sale and the promissory note. These instruments are kept distinct because the introduction of the terms of the contract into the note would jeopardize its compliance with the requirements as to the form of negotiable instruments, contained in the Uniform Negotiable Instrument Law,[20] in force in every state. The note contains

[16] For the usual form of this type of repurchase agreement, see cases cited *supra* note 15.

[17] For the usual form of this type of repurchase agreement, see Gen. Motors Acc. Corp. v. Calhoun Chevrolet Co., 14 La. App. 258, 129 So. 168 (1930).

[18] At least one company's agreement with the dealer provides that no allowance will be made for collision damage if the dealer reveals to the purchaser that he (the dealer) is protected against such damage. See Universal Credit Co. v. Big Sandy Auto Co., 250 Ky. 557, 558, 63 S. W. (2d) 607, 608 (1933). The requirement by some of the large companies, since January 1, 1935, of collision insurance for the purchaser, will thus protect the dealer more effectively.

[19] Western States Securities Co. v. Mosher, 28 Ariz. 420, 237 Pac. 192 (1925); Gen. Motors Acc. Corp. v. Smith, 101 N. J. L. 154, 127 Atl. 179 (1925) (assignment of the secured debt does not require compliance with formalities of motor vehicle transfer law); *cf.* Merchants, etc., Corp. v. Lane, 106 N. J. L. 576, 150 Atl. 559 (1930).

[20] The decisions are in conflict on the question of how far a note may include the provisions of a security contract without impairing negotiability. See BRANNAN, NEGOTIABLE INSTRUMENTS LAW (5th ed., 1932) 127-130. The notes usually contain no reference to the contract although generally this would not impair negotiability. *Ibid.* Negotiability is not, however, affected by the customary attachment of

a promise to pay to the order of the seller the unpaid balance of the purchase price and the financing charges, lumped in a single sum,[21] payable in a specified number of equal instalments. The typical note includes virtually all the auxiliary provisions in aid of enforcement which the Negotiable Instruments Law regards as not impairing negotiability.[22]

1. Provisions in Aid of Enforcement

The principal[23] provisions devised to this end would appear to be those for acceleration of the maturity of instalments not yet due, confession of judgment, collection of a 15 per cent attorney's fee, and waiver of exemption and homestead rights.[24]

"Upon non payment of any instalment the whole sum immediately becomes due and payable." It is usually held optional with the holder to enforce this acceleration clause, whether or not the note provides for the option.[25] It is well to note that the usual step where there is default accelerating payments is to repossess the car, rather than to sue on the note. The contract as well as the note usually contains provision for acceleration in the event of default, a provision of especial utility where the purchaser is in default in some respect other than non-payment of instalments, as, for example, unauthorized sale of the car. If this default took place a few days after an instalment payment had been met, no action could be brought on the note till an instalment was due, since the note only provides for acceleration upon non-payment of an instalment.

The drastic nature of proceedings under warrant of attorney to confess judgment, which eliminates notice and any opportunity to present a defense, has led to statutes[26] or decisions[27] in many states prohibiting such confessions. Statutes requiring the filing of an affidavit signed by the defendant, acknowledging the indebtedness and setting forth the transaction out of which it arose, seem to have effectually served

the note to the contract by perforations. Comm. Credit Co. v. Smith, 143 Misc. 478, 256 N. Y. Supp. 759 (1932). Nor is subsequent detachment a material alteration avoiding the note. Conqueror Trust Co. v. Simmon, 62 Okla. 252, 162 Pac. 1098 (1917). *Contra:* Gen. Motors Acc. Corp. v. Garrard, 41 Idaho 151, 238 Pac. 524 (1925).

[21] The inclusion of the finance charge in the credit price is held to remove the transaction from the operation of the usury laws. For a criticism of this doctrine, see Berger, *Usury in Instalment Sales, supra,* p. 148.

[22] See NEGOTIABLE INSTRUMENT LAW, §§4 (2), 5 (2), 2 (5), 5 (3).

[23] Other provisions of less significance include waivers or prohibitions of the exercise of the right of change in venue or of appeal. These are generally held to be contrary to public policy. Gen. Motors Acc. Corp. v. Talbott, 38 Idaho 13, 219 Pac. 1058 (1923); Gen. Motors Acc. Corp. v. Codigo, 62 Cal. App. 117, 216 Pac. 383 (1923).

[24] The state decisions conflict as to allowing waivers of exemption. Public policy is invoked as the usual ground for not permitting it. (1930) 44 HARV. L. REV. 463. In some states the exemption statute expressly permits waiver. *Ibid.*

[25] Putthoff v. Walker, 213 Mo. App. 228, 248 S. W. 619 (1923).

[26] *E.g.,* ALA. CODE (Michie, 1928) §8047; FLA. GEN. LAWS (Skillman, 1927) §4495; KY. STAT. (Carroll, 1930) §416; MISS. ANN. CODE (Hemingway, 1930) §601.

[27] The cases so holding generally go on the ground of public policy. Hamilton v. Schoenberger, 47 Iowa 385 (1877); First Nat. Bank v. White, 220 Mo. 717, 120 S. W. 36 (1909).

the same purpose.[28] In Indiana and New Mexico procuring the execution of or attempting to enforce a judgment note is a misdemeanor.[29] Even in the minority of jurisdictions[30] which do permit such judgment notes, very definite limitations[31] have been placed on their use. Judgments obtained by confession in states where this procedure is permitted are not always recognized when sued on in states holding the contrary view.[32]

Most states have been more liberal in recognizing stipulations in notes of attorney's fees.[33] Only a few states have outlawed such provisions.[34] The fee is authorized if the note is paid after confession of judgment[35] or after having been placed in the hands of an attorney for collection.[36] The notes usually provide for attorney fees of 15 per cent of the unpaid balance, although one note, used by a large company, provides for a fee of 15 per cent of the entire principal amount of the note.[37] Ordinarily the fee will be allowed unless the defendant purchaser sustains the burden of showing that it is excessive,[38] in which case whatever the jury determines to be a reasonable fee will be allowed.[39]

2. *The Significance of Negotiability*

Aside from the need of absolute negotiability for assuring easy rediscounting,[40]

[28] See McCrairy v. Ware, 6 Kans. App. 155, 158, 51 Pac. 293, 294 (1897); First Nat. Bank v. White, *supra* note 27, at 738, 120 S. W. at 42; U. S. Fid. Co. v. Shickler, 199 App. Div. 74, 191 N. Y. Supp. 194 (1921).

[29] IND. STAT. (Baldwin, 1934) §398; N. M. Laws 1933, c. 48 (adding also possession as indorsee or payee).

[30] *E.g.*, DEL. REV. CODE (1915) No. 4199; ILL. REV. STAT. (Smith-Hurd, 1933) c. 110, §88; PA. STAT. ANN. (Purdon, 1930) tit. 12, No. 316.

[31] The sum must be liquidated or susceptible of liquidation without reference to matters extrinsic to the note, C. I. T. Corp. v. Powell, 166 Md. 208, 170 Atl. 740 (1934), and the authority given must be strictly pursued. Grover Sewing Machine Co. v. Radcliffe, 137 U. S. 287 (1890). Usually the judgment may be reopened or vacated upon filing an affidavit of meritorious defense. Comm. Cred. Co. v. Calkins, 78 Colo. 257, 241 Pac. 529 (1925); Auto Brokerage Co. v. Meyer, 154 Md. 1, 139 Atl. 539 (1927).

[32] The note usually provides for confessing judgment in any court of record in the United States. Whether a judgment so obtained is entitled to full faith and credit under the United States Constitution when the note was made or was payable in a state prohibiting such confessions is a doubtful question. See Note (1930) 44 HARV. L. REV. 1275; (1935) 3 DUKE B. ASS'N J. 32.

[33] As to such a stipulation, one court observed, "Saving the debtor from oppression should not mean relieving him from the force of his own contract and the effects of his own default by absolving him from his contractual liability, and transferring the burden he assumed to the one for whose benefit he engaged to assume it, unless at least the obligation is on its face unjust and oppressive." Comm. Inv. Trust, Inc. v. Eskew, 126 Misc. 114, 116, 212 N. Y. Supp. 718, 721 (1925).

[34] *E.g.*, N. C. CODE (Michie, 1931) §2983; N. D. COMP. LAWS (1913) §7791. *Cf.* NEB. COMP. STAT. (1929) §62-102 (no sum not allowable in other cases).

[35] *In re* Harris, 272 Fed. 351 (M. D. Pa., 1921).

[36] Maxey v. Somerton State Bank, 22 Ariz. 371, 197 Pac. 894 (1921).

[37] Such a basis for determination has been sustained by some courts. Am. Savings Bank v. Sutton, 204 S. W. 572 (Mo. App. 1918) (four-fifths had been paid); *cf.* Dunn v. Vaughan, 120 Okla. 240, 251 Pac. 472 (1926) (no provision in note as to how to be determined).

[38] Osage Oil, etc. Co. v. Dickason-Goodman Lumber Co., 106 Okla. 119, 231 Pac. 475 (1924).

[39] Hillside State Bank v. Christensen, 32 Wyo. 68, 229 Pac. 105 (1924); McCreary v. Stevens, 156 Miss. 330, 126 So. 4 (1930). *Contra:* Phosphate Co. v. Jenkins, 120 S. C. 337, 113 S. E. 317 (1922) (for court, under power to control attorneys).

[40] On the practice as to rediscounting this paper, see GRIMES, FINANCING AUTOMOBILE SALES (1926) 64 *et seq.*

there are certain recurring types of situations in automobile financing where the finance company has found dealer abuses which necessitate cutting off defenses of the car purchaser.[41] The type of defense which one might anticipate would be encountered most frequently, namely, that the car sold was defective, is precluded by a clause in the contract to the effect that "said car is accepted without any express or implied warranties unless written hereon at date of purchase."[42] Such a provision, however, would not protect the dealer in case he made fraudulent misrepresentations to the purchaser.[43] Two other situations in which the finance company finds the note of utility in cutting off defenses are the following:

(1) Trouble with purchasers who had made payment to dealers early led to inclusion in the contracts either provisions that payment to anyone other than the finance company does not constitute payment or more direct agreements not to deal with the seller as agent of the finance company for any purpose whatsoever.[44] In practice, however, the purchaser for the sake of convenience or in response to demand by a fraudulent dealer, sometimes makes payments to the seller. As long as the payments are actually sent in, no trouble arises. However, the danger of dealer payments has led the finance company to keep a check on payments coming from dealers and investigate when such payments reach a certain percentage.

(2) An interesting situation arises where the finance company has been the innocent victim of a so-called "phony deal" which consists of a sale of the contract and note where no car has been sold.[45] Though not nearly so prevalent as formerly,

[41] Since the contract as well as the note contains a promise to pay, an attempt which has been made to obtain the benefits of negotiability by a provision in some of the contracts precluding the purchaser from setting up "any claim against the seller as defense, counterclaim, set-off, cross complaint, or otherwise" is probably invalid. Am. Nat. Bank v. Sommerville, 191 Cal. 364, 216 Pac. 376 (1923). A contrary view has been urged for the sake of business convenience or to effectuate the expressed intention of the parties. Note (1924) 33 YALE L. J. 302; BRANNAN, *op. cit. supra* note 20, at 91. It would seem that if the barring of defenses is desired, it should be effected by complying with the Negotiable Instruments Law. In addition, it may well be argued that the purchaser merely by signing the contract has expressed no real intention to waive such defenses, in view of the lengthy, closely printed contract which he has probably not read, and will not fully comprehend if he does read it. Public policy would seem to forbid such opportunities for deception. Motor Contract Co. v. Van der Volgen, 162 Wash. 449, 298 Pac. 705 (1931).

[42] When the sales contract contains an express warranty, there is a possibility that a court will construe the note and contract together and deny to the finance company the protection accorded a holder in due course. This was done in J. I. Case Co. v. Cox, 178 S. E. 585 (N. C. 1935) (note referred to contract).

[43] But the finance company as holder in due course of the note will be protected. Auto Brokerage Co. v. Ullrich, 102 N. J. L. 341, 134 Atl. 885 (1926). If the note is regarded as carrying with it the right to resort to the security, the defenses may be barred even in actions to recover the property under the contract. Comm. Credit Co. v. Summers, 154 Miss. 501, 122 So. 541 (1929).

[44] The inclusion of such a provision is valuable to give notice and to evidence the general practice. Comm. Inv. Trust, Inc. v. Carrano, 104 Conn. 302, 132 Atl. 870 (1926); *cf.* Gen. Motors Acc. Corp. v. Fletcher, 202 N. C. 170, 162 S. E. 234 (1932) (dealer held to be agent to receive payments in absence of such a provision). Direct payment to the company secures speed in collection, especially important in these transactions. See GRIMES, *op. cit. supra* note 5, at 52.

[45] One of the contracts carries the following warning in large bold face type under the space provided for the purchaser's signature to the contract: "Purchaser Read Before Signing: Purchaser sign here if car is actually in your possession, but do not sign here unless you have actually received the car, since by doing so you might place yourself in the position of being a party to a fraud."

clever but dishonest dealers continue occasionally to mulct the finance companies of large sums. In one scheme, the dealer paid respectable but ignorant people a dollar a month to turn over mail to him from his "mail order company" and induced them to sign sales contracts and notes unknowingly. In turn he sent in payments under their names in varied forms, completely deceiving the finance company. The usually effective precautions used by the finance company, such as, checking the percentage of dealer payments, discreetly-worded form requests to purchasers asking that payments be made direct to the company to avoid inconveniencing the dealer, and the "insurance subterfuge,"[46] availed nothing, and it was only many months later when the dealer had fallen behind in payments that his chicanery was discovered. In other instances forged indorsements of responsible parties were used on contracts of fictitious buyers, the dealer opening accounts in these false names and then making payments. Often a financially irresponsible salesman of the dealer is used as the pseudo-buyer, with the dealer retaining the car and selling it to a third party.[47] As against the dealer the finance company will usually be left to share with general creditors. Negotiability here becomes important in the instances where the maker of the instrument is financially able to pay. In such cases, negotiability serves to prevent interposition of a defense of lack of consideration.[48]

B. THE SECURITY CONTRACT

Rigorous contractual provisions for payment are of little value where the debtor has defaulted and has no money, nor does a provision for retention of title mean much unless there is some way to prevent the property slipping through the fingers of the finance company. As a result, there are in the contract provisions to cover almost every act of the buyer which might lead to such loss. Finance companies operating nationally prepare different contract forms for use in groups of states the relevant laws of which are substantially uniform. Nevertheless, variations of law even within such groups are such as usually render certain of the provisions unenforceable in some of the states for which the contract is designed.[49] The legality of other provisions may remain open to question. The cautious draftsmen of these instruments resolve all such doubts in their own favor,[50] but include in each contract

[46] This consists of a letter stating that there has been a mistake as to the buyer's insurance on his Ford x-1234 and requesting certain information. In reality the buyer is supposed to have Buick q-6789 If he does have the Buick his reply will indicate it, but a reply giving information on the Ford x-1234 would bring immediate investigation. This plan fails where the inquiry is turned over to the dealer by his dupe or accomplice.

[47] The bona fide purchaser has been held to prevail as against the finance company, even where the fictitious contract is recorded. Comm. Credit Co. v. Hazel, 214 Iowa 213, 242 N. W. 47 (1932).

[48] Universal Credit Co. v. Thomas, 170 Miss. 21, 154 So. 272 (1934); Gen. Motors Acc. Corp. v. Larson, 110 N. J. Eq. 305, 159 Atl. 819 (1932); Motor Finance Corp. v. Huntsberger, 116 Ohio St. 317, 156 N. E. 111 (1927).

[49] For example, the provisions for confessing judgment and collecting attorney fees included in one contract for use in the states of Iowa, Kansas, Nebraska, New Jersey, New York, Oklahoma, South Dakota and Wyoming, are obviously not enforceable in all of these states. See notes 27, 28, 34, *supra*.

[50] Thus the contract of one company for Kentucky still provides for resale without notice, although such a provision was held invalid more than two years ago. Gen. Motors Acc. Corp. v. Dickinson, 249 Ky.

a "separability clause" of which the following is typical: "Any part of this contract contrary to the law of any State shall not invalidate other parts of this contract in that State." There is, however, little reason to believe that the inclusion of these outlaw provisions is utilized to gain unfair advantages as may often be the case in some branches of the instalment credit business where amounts involved are smaller and the resort to legal advice less frequent.

As might be expected in such a document drawn purely for protection of the seller and his assignee, the purchaser is left with few, if any, contractual privileges. Statutory enactments of solicitous legislatures,[51] coupled with skilful bits of judicial prestidigitation[52] and the ever-amazing antics of juries[53] have served to curtail to some extent these seemingly secure provisions with results not always fair to the finance companies. Necessity for preserving consumer good-will leads the better finance companies to limit resort to the harsher provisions of the contracts to cases involving fraudulent or obdurate debtors. This fact, together with the reluctance of purchasers to carry cases involving relatively small amounts to the higher courts, leads to a dearth of appellate opinions on many of the points involved.[54] Undoubtedly, however, stringent provisions, even though not generally exercised, have a salutary deterrent effect on irresponsible purchasers.

1. The Form of the Security Device

Collateral security for the personal promise of the purchaser and indorser is usually afforded through the legal device of retention of title to the car sold. This security title passes to the finance company upon the assignment of the sale contract.[55] Title is normally retained through the use of a conditional sale, which is nothing more than a delivery of possession to the buyer subject to the condition that the title to the property shall not vest in the buyer, until payment of the purchase price.[56]

422, 60 S. W. (2d) 967 (1933). The retention of the provision is perhaps justifiable on the theory that the court was influenced in that case by the inequitable nature of the sale, two-thirds of the price having been paid, and may not be so exacting where a much smaller amount has been paid by the purchaser at the time of default.

[51] Although the contracts do not provide for redemption of the property by the buyer after it has been retaken by the seller, the concession has been achieved by the enactment of statutes whose requirements cannot be waived. 3 JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES (6th ed. 1933) §997.

[52] Illustrations of such dexterity are to be found most frequently in the application of the doctrine of election of remedies and in distinguishing between the various forms of security devices, problems which are discussed below. See pp. 237-239, *infra*.

[53] The jury's ability to conveniently overlook testimony is illustrated by Gen. Motors Acc. Corp. v. Sanders, 184 Ark. 957, 43 S. W. (2d) 1087 (1931). Here, despite admitted default and the delinquent buyer's failure to tender the entire sum due, the jury found that he was not in default, a finding which the appellate court felt constrained to accept. See Wilson, *Recent Developments in the Law of Conditional Sales* (1932) 66 U. S. L. REV. 421 at 430.

[54] An examination of a large number of reported cases to which finance companies were parties revealed that in the great majority of such cases the finance companies were the appellants.

[55] See note 19, *supra*.

[56] UNI. COND. SALES ACT, §1; see Vold, *The Divided Property Interests in Conditional Sales* (1930) 78 U. OF PA. L. REV. 713, for an excellent analysis of the nature of the device.

Another device employed for retaining title, chiefly in Pennsylvania,[57] is the bailment lease under which the lessee hires the use of the property, agreeing to pay rent in amount and for a period of time similar to that provided in an instalment sale contract, with the option at the completion of the rental period to obtain title to the car upon the payment of a nominal sum.[58] In adopting the Uniform Conditional Sales Act[59] which treats the bailment lease as a conditional sale,[60] Pennsylvania omitted this provision. Since a bailment lease need not be recorded in Pennsylvania, this exception in the Act has created there the strange anomaly of upholding a device originally devised as a subterfuge to evade Pennsylvania decisions invalidating conditional sales as fraudulent conveyances, after the conditional sale, safeguarded by provisions for recordation, had been accorded statutory recognition.[61] The result has been that the bailment lease is still resorted to in lieu of the conditional sale.

Alternative to the conditional sale and bailment lease is the chattel mortgage, executed by the purchaser to the dealer upon sale of the car, securing payment of the unpaid balance of the credit price.[62] Less stringent recording requirements,[63] possible economies in recording fees, as well as more expeditious remedies in the event of default, have led to concentration on the conditional sales form wherever it is allowed. In Texas, however, the conditional sale is declared to be a chattel mortgage by statute,[64] and in a few states, Colorado, Louisiana, Missouri, Ohio, Michigan, and Washington, judicial decisions,[65] based either on public policy or indistinguishability of the devices, have necessitated use of the chattel mortgage. The theoretical difference between the conditional sale and chattel mortgage transactions is merely formal, the conditional sale in reality being a short cut to an absolute sale with mortgage back.[66] However, courts and legislators in most states have classified them separately,[67] provided for their separate recordation, and, as will be seen, have

[57] Aside from Pennsylvania there is apparently little use of the bailment lease in this country. However, in England a device similar in nature, "the hire-purchase agreement," is widely used for instalment selling. See Midland Motor Showroom, Ltd. v. Newman [1929] 2 K. B. 256; Gough v. Wood & Co. [1894] 1 Q. B. 713.

[58] Gen. Motors Acc. Corp. v. Hartman, 174 Atl. 796 (Pa. 1934). See Montgomery, *The Pennsylvania Bailment Lease* (1931) 79 U. OF PA. L. REV. 920.

[59] Pa. Laws 1925, No. 325, PA. STAT. (Cum. Supp. 1928) §19727 a-1 *et seq.* Eight states and the territory of Alaska have adopted the act. The states are: Arizona, Delaware, New Jersey, New York, Pennsylvania, South Dakota, West Virginia, Wisconsin.

[60] UNI. COND. SALES ACT, §1.

[61] Montgomery, *supra* note 58, at 938.

[62] 1 JONES, *op. cit. supra* note 51, §1.

[63] All states have some recording requirement applicable to chattel mortgages, but only 35 require registration of conditional sales. Hanna, *The Extension of Public Recordation* (1931) 31 COL. L. REV. 617, 638.

[64] TEX. STAT. (Vernon, 1928) art. 5489.

[65] The decisions are collected in 3 JONES, *op. cit. supra* note 51, §§937, 938.

[66] "The chattel mortgage involves three steps—a delivery of possession, a transfer of title to the buyer, and a transfer of title back to the seller for security; while a conditional sale involves one step only—a delivery of possession to the buyer, leaving the title in the seller for security. The result accomplished is absolutely the same." Bogert, *The Evolution of Conditional Sales Law in New York* (1923) 8 CORN. L. Q. 303, 304.

[67] See Quinn v. Bancroft-Jones Corp., 18 F. (2d) 727 (C. C. A. 2d, 1927), where the court said: "While it may be true that mortgages and conditional sales are only formally different, the difference has

permitted important rights of both parties to depend on the category into which a given transaction could be forced. Needless to say, this effort to distinguish Tweedledum from Tweedledee has been prolific in litigation.

Regardless of the form of security device employed, the company's security interest is fortified by conditions[68] which restrict the buyer's privileges of use, sale, and encumbrance of the car or which enable the company to declare the buyer in default in the event that his credit-standing becomes impaired.

2. *Limitations on Use, Sale, and Encumbrance*

A typical clause limiting the use, sale, and encumbrance of the property is set forth below. Upon breach of any condition therein there may be repossession, resale, and suit for deficiency under the contract[69] or an action in tort for conversion:[70]

"Said car shall not be used for taxicab purposes or for hire unless otherwise mentioned herein. Purchaser shall not remove or attempt to remove said car from the county and state given above as Purchaser's address without the written consent of the seller. Purchaser shall not sell, lend, mortgage, assign, encumber, secrete, lose possession or dispose of said car or this contract or any interest therein. Purchaser shall pay all taxes and fees of every nature in connection with said car. Purchaser shall not suffer or permit any lien, encumbrance or charge against or upon said car. Purchaser shall not use or permit said car to be used contrary to any laws in respect to intoxicating liquors, narcotics or other products and shall conform with all laws governing said car."

Provisions against use for hire are reputedly seldom resorted to nor are the ones against illegal use. Normally, as long as payments come in regularly, the finance company will have no cause to investigate. When default in payment has occurred the resort to the hire provision in order to repossess will not be necessary. Apparently this provision is included chiefly to deter attempts to avoid the higher financing charges for cars to be used as taxicabs. Exercise of default remedies against the purchaser in the case of illegal use seldom, if ever, occur. The company will usually obtain notice of such a breach through the seizure of the car and institution of forfeiture proceedings by state or federal authorities. Under most state prohibition laws and the late National Prohibition Act, the finance company was permitted to recover the car upon a showing that it had no knowledge or reason to know that the buyer

long been part of the common law, has been recognized in legislation, and cannot be disregarded by the courts." Thus, although the theory of the Uniform Conditional Sales Act is that the two should be treated alike, the existence of separate statutes and decisions recognizing distinctions of various sorts necessitates keeping the two transactions distinct and the use of different names for each. BOGERT, COMMENTARIES ON CONDITIONAL SALES, 2a U. L. A. (1924) 11.

[68] Actually, these restrictions on the buyer are phrased in the form of promises, being prefaced by "the purchaser agrees," "the purchaser promises." However, it is difficult to conceive of any situation in which the company would sue for breach of one of these promises rather than for the car or its value in tort or for the unpaid balance due under the contract. Since in reality these "promises" are intended as conditions upon which possession and right to attain ownership depend, they should be construed as conditions. See 2 WILLISTON, CONTRACTS (1920) §673.

[69] The use of these remedies is discussed on pp. 235-240, *infra*.

[70] See, *e.g.*, Vermont Acc. Corp. v. Wiltshire, 103 Vt. 219, 153 Atl. 199 (1931) (illustrative of the utility of such a remedy when buyer could have defended in a suit under the contract or note because of infancy).

was using the car illegally.[71] Today, despite the repeal of the Volstead Act, the car may still be confiscated under the federal internal revenue or customs laws.[72] Under these acts, the finance company can rarely recover the car[73] and is left to pursue its remedies against a will-o-wisp purchaser, whose discovery is also being sought for the purposes of criminal action. Losses from this source are few in number, however, because a thorough credit investigation usually reveals with accuracy the buyer's source of income and his occupation, unless he is leading a Jekyll-and-Hyde existence.

The narrowing of state boundaries through improved highways and faster cars would create a tremendous burden on the finance company and buyer if the provisions as to removal were literally enforced. Because of this practical burden and the fact that courts usually do not consider the removal a default unless permanent,[74] the enforcement of default for temporary removal is practically unknown. On the other hand, where the removal is permanent, the purchaser usually complies with the contract by securing written permission to remove the car. Far-flung branch offices of the national companies[75] coupled with the usual standing of the purchaser as a good credit risk facilitate the handling of permanent removal cases. However, "skip" cases, *i.e.*, cases of removal of the car with intent to conceal or defraud, are occasionally encountered. Over a period of years the number of "skip" cases has averaged approximately 5 in 1000.[76] One credit executive has stated that approximately 80 per cent of these cars are recovered. In relatively few instances there have been prosecutions under statutes prohibiting removal with intent to defraud,[77] a

[71] 3 JONES, *op. cit. supra* note 51, §1424 (state rules); Black, *Some Prohibition Forfeiture Cases—the Doctrine of Vicarious Liability* (1930) 78 U. OF PA. L. REV. 518; McDonald, *Automobile Forfeitures and the Eighteenth Amendment* (1931) 10 TEX. L. REV. 141; Note (1925) 11 VA. L. REV. 628.

[72] Internal Revenue Act, 14 STAT. 151 (1878); 26 U. S. C. A. §1182, or the Tariff Act, 14 STAT. 178 (1878); 19 U. S. C. A. §483. When prosecutions were brought under the Prohibition Act, confiscation proceedings had to be brought under its provisions rather than under the revenue or customs laws. Comm. Credit Co. v. U. S., 276 U. S. 226 (1928).

[73] A few exceptions are recognized. If the car has been stolen, forfeiture is avoided. U. S. v. One Ford Coupe, 21 F. (2d) 639 (S. D. Idaho, 1927). Most significant, however, is the provision which has been included in the Tariff and Internal Revenue Acts for some seven years, permitting remission or mitigation of forfeitures incurred without wilful negligence or intention on the part of the owner or lien holder to violate the law. 46 STAT. 757 (1930), 19 U. S. C. A. §1618; 45 STAT. 882 (1928), 26 U. S. C. A. §2709. The procedure is by a petition to the proper cabinet official—the Secretaries of Commerce and the Treasury, the Attorney General. The determination of the rights of the petitioner is not reviewable in any court. General Fin. Co. v. U. S., 45 F. (2d) 380 (C. C. A. 5th, 1930). The standard of care imposed is exceedingly strict, and in practice the result has been that the car is seldom recovered. See McDonald, *supra* note 71, at 145. One petition seen by the writer had been refused even though it set forth that investigation had revealed the tax evader to be a real estate agent of 15 years standing, an eminent citizen of his community, and never known to have been involved in liquor law violations.

[74] Nat. Bond & Inv. Co. v. Dickens, 230 Pac. 911 (Okla. 1924); Street v. Comm. Credit Co. 35 Ariz. 479, 281 Pac. 46 (1929); *cf.* UNI. COND. SALES ACT, §13.

[75] In the case of local companies, the coöperation of the finance company operating in the territory to which the car is removed is often secured, usually through the good offices of finance company trade associations.

[76] This figure is based on reports of the National Association of Sales Finance Companies.

[77] 3 JONES, *op. cit. supra* note 51, §1426.

remedy which is seldom successful because of the difficulty of proving the necessary intent.

Provisions against sale and encumbrance present an interesting variation from the usual practice with respect to real property where sale or encumbrance of mortgaged land is a commonplace. Since the relationship of finance company and purchaser is purely an impersonal one, the practice has become general to waive the condition[78] in the case of sale to a third person, provided he is as good a credit risk as his predecessor. Under Section 13 of the Uniform Conditional Sales Act, provisions against the conditional purchaser selling, mortgaging or otherwise disposing of the property are recognized as valid.[79] In some 27 states unauthorized sale by the buyer is made criminal by statutes of two types.[80] In one type, the mere act of selling without first obtaining written consent is sufficient to constitute the offense, while in the other there must be a fraudulent intent. In some jurisdictions, however, the conditional buyer may transfer or encumber his interest even though there are special restrictions in the contract to the contrary, the transferees being entitled to retain the goods upon payment or tender of full performance.[81]

The related problem of defaults occurring through the accrual of liens of various sorts concerns almost wholly the finance company and the lien claimants. In practice the debtor behind in taxes, owing a large garage bill, or selling the car either fraudulently or of necessity is unlikely to furnish much satisfaction in the event of a judgment. License and personal property taxes are usually the only taxes which are imposed on the conditional purchaser by reason of his interest in the car. Without paying the former he cannot operate the car, and a delinquency in the latter will give the political unit no lien as against the finance company.[82]

3. *Insecurity and Insurance Provisions*

In addition to the specific conditions in the contract restricting use and disposal of the automobile by the purchaser, there are also provisions which may be exercised when the credit standing of the purchaser has become impaired. These may be grouped under the general heading of "insecurity" provisions.

Some of the contracts do no more than state that if "the holder [of the contract] shall deem itself insecure" its contractual remedies may be exercised. This clause

[78] Some of the contracts do not contain any provision for obtaining written consent of the finance company, but instead absolutely prohibit sale.

[79] However, in the absence of contractual provision, this section permits sale or encumbrance if notice is given in writing ten days prior to the transfer.

[80] Commissioners' Note to Uni. Cond. Sales Act, §13, 2 U. L. A. (1922) 23.

[81] Clinton v. Ross, 108 Ark. 442, 159 S. W. 1103 (1912); Davies-Overland Co. v. Blenkiron, 71 Cal. App. 690, 236 Pac. 179 (1925).

[82] Gen. Motors Acc. Corp. v. Whitfield, 253 N. W. 450 (S. D. 1934); Pac. Finance Corp. v. Snohomish County, 113 Cal. 773, 295 Pac. 810 (1931). The clause that the purchaser shall keep the property free of all taxes, etc., was deemed "worthy of consideration" in determining that the finance company was entitled to repossess, despite the fact that the purchaser owed taxes for use of the highways which were by statute a first lien. Universal Credit Co. v. Mamminga, 214 Iowa 1135, 243 N. W. 513 (1932). *Contra:* Motor Dealer's Credit Corp v. Heise, 166 S. C. 389, 164 S. E. 900 (1932). The problem of garage liens will be considered later.

has been sustained as valid,[83] but the courts require that the seller show reasonable cause for insecurity.[84] The application of this criterion of justification will depend on the facts of the particular case.[85] Other contracts, more expansive in terms, give the finance company the right to declare a default:

"If any execution, attachment or other writ should be levied on any of Purchaser's property, or if a petition under the Bankruptcy Act or any amendment thereof should be filed by or against Purchaser or a receiver of the property of the Purchaser should be appointed, or if for any other reason Seller should deem itself or said car insecure, Seller or his representative may take possession. . . ."

Where the company's security interest is senior to that of the attaching creditor, trustee in bankruptcy, or receiver, the value of this power to repossess is evident. Conversely, it is of no value where the company's interest is junior to that of the purchaser's creditors. The problem of priorities will be discussed in a later section.

To protect the property against damage or destruction, the contracts either provide that "Seller may insure said property against fire and theft to properly protect Purchaser and Seller and Purchaser shall pay the premium" or "Purchaser shall keep said car insured against fire and theft payable to and protecting Seller, for not less than the total amount owing on said note until fully paid, and Seller may place said insurance at Purchaser's expense, if Seller so elects." Coupled with the insecurity provisions noted above, there is usually a provision that cancellation of this insurance by the insurance company places the purchaser in default under the conditional sale contract.

Formerly, the contracts provided that the purchaser would procure insurance satisfactory to the seller. The result was frequent loss because of insuring in small, fly-by-night companies. Today the practice is universal to include insurance premiums in the financing charges, the account being turned over to a broker to place. As previously noted,[86] the trend is now towards requiring collision insurance—which has always been urged—as well as the standard fire and theft coverage. Apparently the proceeds would be used to discharge the balance due, but some contracts provide that the money may be used toward replacement of the property or payment of the obligations, at the option of the seller.

A problem of risk of loss arises when there is damage not covered by insurance, such as collision. In but one of the contracts examined by the writer is there an express provision that the property shall at all times be at the purchaser's risk. This provision is declaratory to the very general rule that the risk of loss in conditional sales is on the buyer.[87] Where the car is injured by the negligence of a third party, the finance company may sue for the damage done,[88] its recovery being limited to

[83] ESTRICH, INSTALMENT SALES (1926) §360.

[84] *Ibid.*, citing Hines v. Pacific Car Co., 110 Wash. 75, 188 Pac. 29 (1920).

[85] 3 JONES, *op. cit. supra* note 51, §1296. [86] See note 18, *supra*.

[87] UNI. SALES ACT, §22 (a); UNI. COND. SALES ACT, §27. As to the weight of authority at common law, see 1 WILLISTON, SALES (2d ed. 1924) §304.

[88] Barnes v. United Ry., 140 Md. 14, 116 Atl. 855 (1922); see Carolina, C. & O. Ry. v. Unaka Springs Lumber Co., 130 Tenn. 354, 381, 170 S. W. 591, 598 (1914).

the balance due.[89] Contributory negligence of the purchaser is no defense in such an action,[90] but a previous settlement by him does bar a subsequent suit by the finance company.[91] In the case of settlements, it is generally said that the conditional buyer must account to the seller or his assignee to the extent of his interest.[92] Actually the experience of finance companies has often been that a judgment-proof purchaser, having been involved in a wreck, will sign a release for a consideration. Rather than leave the finance company with a piece of worthless junk it would not seem too harsh, at least in certificate of title states, to require the tortfeasor to make a reasonable attempt to ascertain whether or not the injured party has title to the car.

THE DELINQUENT PURCHASER

Regardless of the purchaser's success in observing or evading the foregoing conditions imposed by the contract, let him once fail to obey the commandment, "Thou shalt pay," and immediate action on the part of the finance company is sure to be forthcoming. However, everything possible is done to facilitate payment. Immediately upon its purchase of the debt, the company sends notice[93] to the car purchaser by form letter. The form letter states that Ardue Finance Company has purchased his conditional sale contract and note, that payments are to be sent to the office designated on the outside cover of the enclosed handy little coupon book, containing a coupon with number, amount and date of each payment, one to be sent with each remittance "for certainty of our records." In addition, advance notice is given of the pendency of each instalment.

Generally the defaulter shows up within the first three months after purchase.[94] Once past the first few payments, the purchaser will move heaven and earth to protect his "equity." There is normal expectancy that 980 out of every thousand will complete the transaction; even in present times, the expectancy is 950 per thousand.[95]

[89] The authorities are not at all clear on this point, but the above statement seems to be the majority rule. Lacey v. Great Northern Ry., 70 Mont. 346, 225 Pac. 808 (1924); 1 WILLISTON, SALES, §333; ESTRICH, *op. cit. supra* note 83, §§220, 221. Since it is usually held that the purchaser may recover the full value, holding the company's interest in trust, it would seem on principle that the converse of the rule should be applied here to prevent multiplicity of actions.

[90] Comm. Credit Co. v. Satterthwaite, 107 N. J. L. 17, 150 Atl. 235 (1930); Note (1930) 40 YALE L. J. 135.

[91] Ellis Motor Co. v. Hancock, 38 Ga. App. 788, 145 S. E. 518 (1928); Harris v. Seaboard Airline Ry., 190 N. C. 480, 130 S. E. 319 (1925).

[92] Carolina, C. & O. Ry. v. Unaka Springs Lumber Co., *supra* note 88.

[93] A failure to send notice is important in case the note is declared non-negotiable. In such a case, failure to give notice would permit the defense of payment or a binding change in the contractual terms. Stella v. Bankers Comm. Corp., 197 App. Div. 515, 189 N. Y. Supp. 511 (1921); Hare & Chase v. Volansky, 127 Misc. 26; 215 N. Y. Supp. 168 (1926).

[94] The incidence of default is elaborately examined in 2 SELIGMAN, *op. cit. supra* note 8, at 405-506. The writer has been informed by credit executives of leading finance companies that early default is encountered most frequently in the winter season when cars are a source of more trouble and less enjoyment and when increased personal needs diminish the buyer's cash resources. The repossession study in Seligman indicated a precisely contrary result. Winter purchasers were more cautious.

[95] *Sales for Sale* (Jan. 1933), 7 FORTUNE 72.

A. PROBLEMS OF COLLECTION AND ADJUSTMENT

Although such defaults seem inconsiderable when compared with total sales, laxity by the company would soon prove a stepping stone to impositions. Yet the exercise of strict default according to the letter of the contract would be at the cost of consumer and dealer good will. The situation requires the exercise of discriminating judgment. It appears that the finance company will seek to adjust the difficulty or repossess the car within a period of thirty days.

Within a day or two of default in payment, there comes the first of several form letters, courteous but increasingly firm, advising of the overdue payment. If no response is received, a personal contact is usually made where possible. In some cases, where the dealer is working under a repurchase agreement, he himself may do the contacting and help to adjust the difficulty, but more usually the adjuster of the finance company is assigned the burden. The result of the personal visit is either a payment, a promise to pay within a few days, or a refusal, often coupled with the assertion of a supposed defense. Occasionally there is voluntary surrender of the car. A promise to pay or payment ends the difficulty at this time, but acceptance of payment does not preclude declaration of default for non-payment of a subsequent instalment.[96]

More often the buyer finds that he cannot meet the terms of the contract, although able to pay if given more time. In such cases if the finance company is convinced that the buyer is still a good moral risk from a credit standpoint, there may be either a short extension of time on the unpaid instalment or a revision, oral or written, of the credit terms of the contract.[97] Since the business of the companies is financing, not refinancing, extensions will often be refused, and the purchaser will frequently fall into the hands of one of the so-called refinance companies, which pays off the balance due the finance company and takes over the conditional sale contract and note. Their operation is essentially that of a small loan company,[98] and at the hands of one of the many unscrupulous operators in this field, the purchaser soon undergoes

[96] Pac. Finance & Inv. Co. v. Pierce, 48 Cal. App. 494, 191 Pac. 1115 (1920).

[97] The helplessness of an individual against an unscrupulous creditor holding a valid legal instrument is illustrated in this situation by the practice of racketeering companies which take advantage of inconsequential defaults to seize cars for the sake of obtaining a repossession charge when the purchasers seek their return. The fee usually is based on the size of the equity. Nugent and Henderson, *Instalment Selling and the Consumer* (1934) 173 ANNALS 93, 97. The better companies do not resort to this practice of repossessing merely to extort a repossession fee, when it is contemplated that the contract will be revised or some other adjustment made. Delinquency charges, however, are sometimes levied. *Id.* at 98.

A proposed "Instalment Sales Financing Law" in Massachusetts would practically preclude such skullduggery, by a section providing: "No other charges, bonus, fee, expense, or demand of any nature whatsoever shall be made so long as the buyer fulfills the conditions of the contract; and no fines, penalties, or charges shall be made for delay, delinquency, repossession, refinancing, legal expense or other cause unless such charges are specifically set forth in the contract both as to amount and as to the conditions under which they may be imposed." Mass. Sen. Bill No. 55, §218 (1935). The Indiana Retail Installment Sales Act of 1935 includes provisions substantially similar in effect. Ind. Acts 1935, H. B. 377, §§6, 7.

[98] For a discussion of the operation of the small loan business, see CLARK, FINANCING THE CONSUMER (1931) 25 *et seq.*

financial torture which by comparison makes his former relation with the finance company a pleasant one.

When the purchaser in default can be carried no further, the finance company, in the usual case, rather than sue at once for the balance due under the note, resorts to the property.

B. PROBLEMS OF REPOSSESSION

With a few variations, the contracts provide upon default that:

> "Seller or his representative may take possession of said car, and all equipment, accessories or repairs thereon, which shall be considered a component part thereof, wherever it may be found, and may enter any premises therefor without notice or demand to Purchaser and without legal process, and Purchaser waives all claims for damages caused thereby."

To regain possession of the property, apparently there is in general no resort to legal process, the waiver being generally effective.[99] In the case of furniture or domestic appliances, a couple of husky movers will be sent after the property, and seldom fail to return with it.[100] The license to enter upon the premises is generally considered irrevocable,[101] and in exercising it the vendor may exercise such force as may be necessary.[102] But in case of resistance, the finance company must, at its peril, stop at the precise point where sufficient force ends and excessive force begins.[103] However, objections and protests of the conditional purchaser do not make an otherwise rightful retaking wrongful, unless there is a breach of peace committed by the seller's agent.[104] More generally in the case of automobiles, there will be no entry upon the premises but a "lifting" of the car from the street where the vendee has parked it.[105] Usually there need be no prior demand for payment[106] or delivery of the goods unless for some reason, such as a prior waiver of prompt performance, the purchaser is equitably entitled to notice.[107] In Missouri and Ohio, there can be

[99] C. I. T. Corp. v. Reeves, 112 Fla. 424, 150 So. 638 (1933); Sunel v. Riggs, 93 Wash. 314, 160 Pac. 950 (1916).

[100] The abuses which may naturally arise from entering a person's household to recover property led to the inclusion in Section 224 of the Massachusetts bill, *supra* note 97, of a requirement that household goods must be retaken by legal process.

[101] 3 JONES, *op. cit. supra* note 51, §1339.

[102] Lambert v. Robinson, 162 Mass. 34, 37 N. E. 753 (1894); *cf.* (1935) 19 MINN. L. REV. 602.

[103] See v. Automobile Discount Corp., 330 Mo. 906, 50 S. W. (2d) 993 (1932); Gen. Motors Acc. Corp. v. Davis, 151 Okla. 255, 7 P. (2d) 157 (1931); 3 JONES, *op. cit. supra* note 51, §1339.

[104] UNI. COND. SALES ACT, §16 (if goods cannot be retaken without breach of the peace, they shall be retaken by legal process); Bankston v. Hill, 134 Miss. 288, 98 So. 689 (1924); La Porte Motor Co. v. Firemen's Ins. Co., 209 Wis. 307, 245 N. W. 105 (1932); see C. I. T. Corp. v. Reeves, *supra* note 99.

[105] Such a retaking, even without knowledge of the buyer, is valid. Gen. Motors Acc. Corp. v. Shuey, 243 Ky. 74, 47 S. W. (2d) 968 (1932).

[106] ESTRICH, *op. cit. supra note* 83, §§369-372; *cf.* UNI. COND. SALES ACT, §17 (seller has option of giving notice 20-40 days before repossession of intention to retake, or of retaking without notice and permitting a ten day redemption period).

[107] Pac. Fin. Corp. v. Webster, 161 Wash. 255, 296 Pac. 809 (1931); Peoples Furn. Co. v. Crosby, 57 Neb. 282, 77 N. W. 658 (1898). And when there is actually no default, the finance company is liable for conversion, the damages including the buyer's loss of use of the car. Comm. Credit Co. v. Miron, 108 Conn. 524, 143 Atl. 846 (1928).

no repossession unless prior payments, less a reasonable amount for use and damage, are returned.[108]

When repossession through legal process becomes necessary because of resistance by the buyer or for other reasons,[109] an action of replevin or of claim and delivery is brought. Apparently such actions are seldom contested, but the costs, ranging approximately from $2.50 to $7.00, make repossession without such a device more acceptable to the finance company.[110]

Immediately upon repossession there arise problems as to accessories attached to the car and property contained therein. Accessories which belong to the car purchaser pass to the finance company under such a contract provision as the one noted above.[111] Where title to the accessories has been retained by another conditional seller, recovery will depend on the manner in which they are attached.[112] As to property in the car, a question arises where there has been repossession without legal process. Foreseeing possible fraudulent claims as to such property, the finance companies make a practice, upon repossession, of immediately removing the car to a garage and there checking the contents with the adjuster and garage employees serving as witnesses.[113] Usually the property is returned upon request by the purchaser. In one contract there is a requirement of notice by the purchaser within 24 hours after repossession of any claim for articles not included in the repossession statement, with an option in the holder in the absence of such notice "to make such disposition of the property as it shall deem fit."

[108] Under the Missouri statute the amount paid in makes no difference, but the seller is allowed to deduct a reasonable compensation for use of the property which in no case shall exceed 25 per cent of the payment. MO. REV. STAT. (1919) §2285. The Ohio statute does not require tender unless at least 25 per cent has been paid by the buyer and up to 50 per cent may be deducted as compensation for use. OHIO GEN. CODE (Page, 1926) §8570.

[109] There is prevalent in certain sections of the county a definite "holding up" of finance companies in their efforts to repossess peacefully. This consists in threats of police officers, sometimes accompanied with actual force, to prevent repossession without resort to legal process. Little reason can be found for such obstructions except the desire to obtain fees.

[110] The adjusters of the finance company may follow a delinquent purchaser for several days until an opportune moment for retaking the car appears. This done, there is seldom, if ever, complaint as to the method of retaking.

[111] Lynch v. Sable-Oberteuffer-Peterson, 122 Ore. 597, 260 Pac. 222 (1927).

[112] Accessories may be removed if this will not damage the whole car. Motor Credit Co. v. Smith, 181 Ark. 127, 24 S. W. (2d) 974 (1930). Even though the contract provides "that any added or substituted parts, body or equipment, placed upon the car during the life of this agreement . . . shall become a component part thereof," the seller of tires is still entitled to them. Tire Shop v. Peat, 115 Conn. 187, 161 Atl. 96 (1932). The solution to this problem does not depend on recording acts but rather on whether the doctrine of title by accession applies to automobile equipment which is easily removable. The holding of Tire Shop v. Peat, *supra*, seems sound on the theory that the contract between the automobile dealer and the purchaser can not bind property subsequently acquired, in which another person, not a party to this contract, has reserved a security title. However, conversely, whether the accessories seller may secure a lien on the car for the price of the accessories would depend on the recording acts and the lien statutes. See discussion of garage liens, p. 242, *infra*.

[113] This practice seems to have effectually prevented suits on fraudulent claims, and no cases have been encountered in which the exact problem arose in a civil suit. In Universal Credit Co. v. Wyatt, 56 S. W. (2d) 487 (Tex. 1933), the buyer claimed $14 for damages for property in the car in addition to other damages, but no further mention of the claim is made in the case. In a Kentucky case, an adjuster was held guilty under a statute making it a misdemeanor for one to take property of another without criminal intent. Commonwealth v. Larson, 242 Ky. 317, 46 S. W. (2d) 82 (1932).

C. PROBLEMS OF RESALE

Upon repossession of the car, there arises a direct conflict in the interests of the finance company and the purchaser, depending on whether or not the value of the car is greater or less than the unpaid balance. It is in the effect that repossession has on the rights of the parties that the difference in development of the rules applicable to the conditional sale and the chattel mortgage have been most apparent.[114] Where a mortgaged car had been repossessed by the mortgagee, the mortgagor still had a right to redeem it by paying the sum in default.[115] If there were no redemption, the mortgagee could sell the car and apply the proceeds to the liquidation of the debt, plus costs of repossession and resale. The mortgagor was entitled to any surplus with a corresponding right in the mortgagee to a decree for any deficiency.[116] In addition, prior action for the chattel mortgage debt did not bar the subsequent foreclosure of the chattel mortgage.[117] These equitable principles were not embodied in the law as to conditional sales. Generally, the buyer was permitted no redemption.[118] On the other hand, if the seller elected to repossess, he was regarded as having rescinded the contract and had no further right to sue the buyer for the unpaid balance, and conversely, if he elected to sue, he was debarred from repossessing the property.[119] Although the courts talked of rescission, the seller was usually permitted to retain the payments.[120] Corollary to the denial of suit for a deficiency was a refusal of courts to require the seller to account for any surplus in case of resale.[121]

[114] The development in equity of the law of mortgages, the development at law of the law of sales, and the imperfect "procedural coalescence of law and equity" offer a historical explanation of the practical differences existing in the formally similar conditional sale and chattel mortgage. Note (1923) 36 HARV. L. REV. 740.

[115] Before foreclosure or sale, the mortgagor may redeem in equity within a reasonable time, even though such right of redemption is not conferred by statute. Kinkead v. Peet, 153 Iowa 199, 132 N. W. 1095 (1911); Penobscot Produce Co. v. Martin, 128 Me. 386, 147 Atl. 867 (1929); *cf.* McQuagge v. Thrower, 214 Ala. 582, 108 So. 450 (1920). "This may be regarded as a settled rule in every state whose courts have full equity powers, and where redemption has not been specially provided for by statute." 2 JONES, *op. cit. supra* note 51, §85.

[116] "The ground on which equity entertains such a bill is, that the property may be sold under the direction of the court; that, if it falls short of satisfying the debt, the mortgagee may have a decree for the residue; or, if there should be a surplus, that it may be awarded to the mortgagor, and so put an end to litigation. If the mortgagee should sell, himself, there would be, in case of deficiency, an action at law to recover the remainder of the debt; or, if there should be a surplus, the mortgagor might sue for it. Equity makes an end of these matters." Chancellor Harper in Bryan v. Robert, 1 Strob. Eq. 334, 343 (S. C. 1847)

[117] Elder v. Rouse, 15 Wend. 219 (N. Y. 1836).

[118] Burdick, *Codifying Conditional Sales Law* (1918) 18 COL. L. REV. 102, 108.

[119] 2 WILLISTON, SALES, §§579, 579a.

[120] Logically, the seller's act of repossession can be treated as rescission only if he is required to place the buyer *in status quo* by returning the payments made on the contract, less a reasonable sum for use and damage. See C. W. Raymond Co. v. Kahn, 124 Minn. 426, 429, 145 N. W. 164, 166 (1914). A few states require this. See *e.g.*, Pierce v. Staub, 78 Conn. 459, 62 Atl. 760 (1906); Quality Clothes Shop v. Keeney, 57 Ind. App. 500, 106 N. E. 541 (1914). More properly repossession can be said to be an enforcement, rather than a rescission, of the contract and consequently there is a right to retain payments. Rayfield v. Van Meter, 120 Cal. 416, 52 Pac. 666 (1898); Mohler v. Guest Piano Co., 186 Iowa 161, 172 N. E. 302 (1919); Vold, *supra* note 56, at 725; Note (1932) 17 MINN. L. REV. 66, 70.

[121] The theory of the courts which have adhered to this doctrine is that two inconsistent courses are open to the seller, one to recover the goods and disaffirm the contract, the other to bring an action for the

This doctrine of "election of remedies" worked to the satisfaction neither of instalment sellers nor of buyers, and it has been the object of much criticism by legal commentators.[122] Gradually, the differences between the conditional sale and the chattel mortgage have been whittled down, in some states by judicial decision and in others by statute. This process has been accelerated, as will be seen, by the contracts generally employed by finance companies.

The Uniform Conditional Sales Act has gone far towards assimilating the law of conditional sales to that of chattel mortgages. In the nine jurisdictions[123] where it is in effect, the buyer is allowed ten days after repossession in which to redeem by tender of the amount due under the contract at the time of the retaking with interest and the costs of repossession.[124] Under proper exercise of the redemption right the purchaser may "continue in the performance of the contract as if no default had occurred."[125] The statement quoted has been held to defeat the operation of the acceleration clause.[126] A few states which have not adopted the Uniform Act nevertheless have recognized, by statute[127] or decision,[128] a right of redemption in the purchaser.

However, even where redemption is permitted, in many cases the property will not be redeemed either because of the buyer's inability to raise the money or his belief that the property is worth less than the balance due. For a fair adjustment of the rights of the parties, there remains the necessity of providing for suit by the seller in case of a deficiency and for payment to the buyer in case of a surplus.

Proceeding, therefore, by analogy, to chattel mortgage law, the Uniform Act as a condition precedent to a suit for a deficiency by the seller requires a resale in com-

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price and thus affirm it as a sale. See 2 WILLISTON, SALES, §579. "It is believed that the doctrine of election was in large part the result of the struggles of the law courts, hampered by an inadequate procedure, to do equity between the parties." Note (1929) 29 COL. L. REV. 960, 1123, at 961. This note contains a penetrating study of the doctrine as developed in Massachusetts, California, and Mississippi cases.

[122] The criticisms in the main have taken three lines: (1) By denying the seller the two remedies for which his contract provides, the express intention of the parties is negatived; (2) That the doctrine is often based on the misconception that a conditional sale is an executory contract to sell, when in reality the seller has only retained a security title, which he should be permitted to foreclose; (3) It works a hardship on both parties since it denies the seller the right to sue for a deficiency, and gives no opportunity to the buyer to redeem his interest, which may exceed the balance due. See 2 WILLISTON, SALES, §579; VOLD, SALES (1931) §§95, 96; Magill, *The Legal Advantages and Disadvantages of the Various Methods of Selling Goods on Credit* (1922) 8 CORN. L. Q. 210, 215-221.

[123] For the states adopting this act, see note 59, *supra*.

[124] By giving notice in writing, 20 to 40 days in advance, of intention to retake, the seller may eliminate the right to redeem. UNI. COND. SALES ACT, §17.

[125] *Id.*, §18.

[126] Street v. Comm. Credit Co., 35 Ariz. 479, 281 Pac. 46 (1929); Harlee v. Fed. Finance Corp., 4 W. W. Harr. 345, 152 Atl. 596 (Del. 1930); Cox v. Gen. Motors Acc. Corp., 59 S. D. 588, 241 N. W. 609 (1932).

[127] See, *e.g.*, Minn. Laws (1931) c. 339, §3. In some ten states which require, or permit the buyer to require, resale when a certain amount has been paid in, an opportunity to redeem is in effect secured to the buyer. Commissioners' Note to Uni. Cond. Sales Act, §18, 2 U. L. A. (1923) 29.

[128] Perkins v. Skates, 220 Ala. 216, 124 So. 514 (1929); Mercier v. Nashua Buick Co., 84 N. H. 59, 146 Atl. 165 (1929).

pliance with its rules, and, to protect the buyer against forfeiture in the situation where loss to him is most likely, requires such resale where he has paid more than 50 per cent of the purchase price.[129] Other statutes of this type also exist in a few states.[130] Even in states where such statutes do not obtain, the finance companies, to avoid the doctrine of election of remedies, have now quite generally provided in their contracts for such protection[131] by inclusion of a clause of which the following is typical:

> "The property may be sold with or without notice, at public or private sale at which the holder may purchase, and the proceeds, less the expense of taking, removing, holding, repairing and selling the property and less attorney's fees as above provided and the expense of liquidating any claims or liens, shall be credited on the amount unpaid hereunder; or without such sale the fair market value of the property at the time of repossession may be credited upon the amount unpaid; in either event Purchaser agrees to pay the balance forthwith as liquidated damages for the breach of this contract; any surplus shall be paid to the Purchaser."

Such a clause as this is generally held to remove the objection that the seller's repossession has constituted an election of remedies.[132] Even where such a provision is not present, a number of courts have permitted the conditional seller to treat the reserved title as a lien and to bring proceedings to foreclose it.[133]

In the absence of statute, the contractual provisions governing the manner of resale are generally upheld.[134] But a number of states have statutory regulations governing such sales, and these may not be waived.[135] Such statutes generally require a public sale within periods ranging from fifteen to sixty days after retaking.[136] In compulsory resale under the Uniform Act, the property must be sold at public auction within thirty days after retaking and after ten days' written notice to

[129] UNI. COND. SALES ACT, §19. The resale was made compulsory in this situation to protect the rights of small debtors poorly informed as to their status. But the experience with resale has shown that where less than 50 per cent is paid in, the requirement of resale is a useless and expensive formality. Therefore, Section 20 makes resale in the latter situation optional with the parties. The seller need not comply with formalities as to resale in this situation unless he desires to sue for a deficiency. UNI. COND. SALES ACT, §23. See Commissioners' Note to §§19, 20, 2 U. L. A. (1923), 33, 35.

[130] *E.g.*, TENN. CODE (Shannon, 1932) §§7287, 7292 (compulsory); MASS. ANN. LAWS (1933) c. 255, §13 (optional with buyer; 75 per cent must have been paid in). See Ohio and Missouri statutes, *supra* note 108, making refund condition precedent to repossession.

[131] This clause is in the nature of a general foreclosure clause in a chattel mortgage except that it does not provide for a right of redemption. Chattel mortgage forms, where used, also omit provision for redemption, but the right exists independently of contract or statute. See cases cited *supra* note 115.

[132] Smith v. Harrington, 41 Idaho 155, 238 Pac. 530 (1925); La Salle Finance Co. v. De Jarnet, 95 Ind. App. 468, 181 N. E. 164 (1932); First Nat. Bank v. Yocom, 96 Ore. 438, 189 Pac. 220 (1920). *Contra:* Nashville Lumber Co. v. Robinson, 91 Ark. 319, 121 S. W. 350 (1909). See 3 JONES, *op. cit. supra* note 51, §§1311, 1327.

[133] VOLD, SALES, §96; 3 JONES, *op. cit. supra* note 51, §1367.

[134] Comm. Credit Co. v. Cook, 165 S. C. 394, 164 S. E. 17 (1932).

[135] See note 130, *supra*. The Uniform Conditional Sales Act, §26, prohibits waiver except of certain specified things. The same result has been reached by decision in states having resale statutes. Desseau v. Holmes, 187 Mass. 486, 73 N. E. 656 (1905).

[136] Commissioners' Note to Uni. Cond. Sales Act, §19, 2 U. L. A. (1923) 33.

the buyer.[137] There is a strict penalty on the seller for failure to comply with these provisions.[138]

It is far from certain that these statutory safeguards always work to the buyer's advantage. A forced sale at public auction at which his creditor may be a bidder is not likely to yield a surplus. This may be true even in a favorable market,[139] and where demand has fallen off, the buyer's equity is certain to be wiped out.

INTERESTS OF THIRD PERSONS

There is a risk of deception to third persons inherent in the delivery of possession of a chattel to a purchaser while the seller retains a security title for payment of the price. Objections to such secret liens usually availed nothing at common law where the doctrine prevailed that a conditional seller or chattel mortgagee could not be deprived of his property in the goods without his consent.[140] The harshness of such a rule as against those who made expenditures on the strength of the purchaser's apparent ownership inevitably led to the adoption of a device designed to protect third parties, while at the same time preserving the security of the seller. This device is the recording act. Thus, there are now statutes in every state for recordation[141] of the chattel mortgage, and in most, for recordation of the conditional sale and bailment lease.[142] These statutes designate a place of registration,[143] *e.g.*, the county clerk's office, where the contract may be recorded, and specify a certain time within which the contract must be recorded. Persons who wish to buy personal property or lend money on its security may, therefore, ascertain from the records whether there are any prior claims to which the property is subject.

Since there are usually separate recording acts for conditional sales and chattel

[137] UNI. COND. SALES ACT, §19. The Act has no provision requiring the property to be present, but it has been held that the common law requirement as to the property being present at the place of sale still prevails. Strickland v. Hare & Chase, Inc., 217 App. Div. 196, 216 N. Y. Supp. 506 (1926); Comm. Inv. Trust, Inc. v. Browning, 108 W. Va. 585, 152 S. E. 10 (1930).

[138] For failure to observe the resale provisions, the seller is liable to the buyer for actual damages, if any, "and in no event less than one-fourth of the sum of all payments which have been made under the contract, with interest." *Id.* §25.

[139] "The sale of repossessed cars by companies financing used cars is frequently scandalous. . . . In some of these auction markets . . . the difficulties of an unknown individual in bidding are reminiscent of the farm foreclosure sales of 1932. Sales of repossessed cars are frequently the happy hunting ground of a closed membership of used car dealers whose objections to intruders might take violent forms. . . . These abuses, though exceedingly common, do not apply to instalment selling as a whole." Nugent and Henderson, *supra* note 97, at 97.

[140] WILLISTON, SALES, §§324, 325.

[141] Recordation as used in the above discussion includes filing. Chattel mortgages are more commonly recorded, while filing is generally required for conditional sales. HANNA, CASES AND MATERIALS ON SECURITY (1932) 323, 324.

[142] Thirty-five states require the recording of conditional sales of personal property, but, in every jurisdiction, chattel mortgages of certain types of personalty must be recorded, if the mortgagor retains possession. Bailment leases are generally held to be subject to the recording requirements for conditional sales, except in Pennsylvania, where no recording of the bailment lease is required. The recording statutes of the states are analyzed and their variations indicated in HANNA, *op. cit. supra* note 141, at 312-327.

[143] The county almost universally is the unit constituting a recording district, but the statutes vary as to whether recording is to be determined by the situs of the property or the residence of the buyer or seller, or both situs and residence. *Id.* at 320-323.

mortgages, the requirements of which vary from state to state and even within a state, no extended discussion of the effect of such recording requirements can be attempted here.[144] However, several generalizations may be made. In the first place, persons with notice of the seller's interests are not entitled to attack a transaction which has not been recorded.[145] In addition, almost all of the acts protect only persons who have given value.[146] Subpurchasers and creditors are the usual classes protected,[147] but most acts include only those creditors who have reduced their claims to judgment, acquiring liens by attachment or levy.[148] Some statutes protect subsequent mortgagees. Under the 1910 amendment to the National Bankruptcy Act, a trustee in bankruptcy of the purchaser is accorded the status of a lien creditor and will therefore prevail against a finance company which has not recorded its contract.[149] However, recording of the contract or the retaking of the car within four months of bankruptcy is not a preference, and the finance company's interest will be preserved.[150] In case of receivership, the receiver is generally accorded no lien because of his position as receiver.[151] In practically every state the requirement that the contract must be recorded within a certain period of time is regarded as giving a grace period within which the finance company is protected in the absence of recordation, and recordation after its expiration is effective as against parties whose claims accrue subsequently to such recordation.[152]

The mobility of chattels in general and the automobile in particular has led to a problem not presented under real property recording acts, where a search of the records in the recording district in which the land is located will generally reveal the owner's interest in the property. But once a car has been removed from the record-

[144] Although recording for conditional sales developed subsequent to the requirement of this formality for chattel mortgages, it might be supposed that the statutory requirements would be the same. A striking example of the fallacy of such an assumption is furnished by New York, where an unfiled conditional sale is invalid against purchasers or lien creditors, while an unrecorded chattel mortgage is invalid against general creditors. N. Y. CONS. LAWS (Cahill, 1930) c. 34, §230, c. 42, §65.

[145] ESTRICH, *op. cit. supra* note 83, §199. Recording serves as constructive notive, but what constitutes notice in the absence of such recording is difficult of decision. BOGERT, *op. cit. supra* note 67, at 80. In at least one state, North Carolina, "no notice, however full and formal, will supply the place of registration." See North State Piano Co. v. Spruill, 150 N. C. 168, 169, 63 S. E. 723, 724 (1909).

[146] "Just what is meant by 'value,' however, is not always susceptible of exact definition, and each case must be largely its own criterion, to be determined upon its own facts. The payment of money, of course, is value, as is the surrender of other property." JONES, *op. cit. supra* note 51, §1098.

[147] For a discussion of the persons protected by recording statutes, see ESTRICH, *op. cit. supra* note 83, §§168-177.

[148] Vold, *supra* note 56, at 731. Some states, however, recognize general creditors, varying as to whether the credit need be extended subsequent to the transaction. The like variation exists as to lien creditors. The cases are collected in BOGERT, *op. cit. supra* note 67, at 81-88.

[149] 36 STAT. 840 (1910); 11 U. S. C. A. §75 (a) (2). Under this amendment, wherever lien creditors are made superior to the finance company because of failure to record, the trustee will prevail. JONES, *op. cit. supra* note 51, §1143.

[150] Bailey v. Baker Ice Machine Co., 239 U. S. 268 (1915) (recording); *In re* Johnson, 282 Fed. 273 (W. D. Iowa, 1922) (retaking).

[151] Quinn v. Bancroft-Jones, 18 F. (2d) 727 (C. C. A. 2d, 1927); Delaware Trust Co. v. Elder, 12 Del. Ch. 263, 112 Atl. 370 (1920).

[152] Comm. Credit Co. v. Gaiser, 134 Kans. 552, 7 Pac. (2d) 527 (1932); Morey & Co. v. Schaad, 98 N. J. L. 799, 121 Atl. 622 (1923); Motor Exchange Co. v. Comm. Inv. Co., 151 Okla. 176, 3 Pac. (2d) 178 (1931); Bent v. Weaver, 106 W. Va. 164, 145 S. E. 594 (1928).

ing district, a search of the records in the state to which it has been taken will reveal nothing to the prospective purchaser or lender. Generally the rule is that the finance company is protected against such third parties until it has actual notice of the removal and time to record again.[153] In some states, where a desire to protect residents is paramount, the company is held subordinated to the claim of an innocent third party.[154] Although this minority view has been criticized,[155] it is not without some justification. The finance company has placed it within the power of the purchaser to move the property from place to place, despite the contractual prohibition against his doing so. In determining whether or not the finance company should be protected as against third parties, three considerations must be weighed: (1) the relative severity of the loss of the subpurchaser or creditor as compared with that of the finance company which can insure itself against such risks; (2) the fact that car purchasers and creditors actually seldom do consult the records; and (3) the risk that failure to recognize the finance company's title would materially augment the number of "skip" cases by facilitating the disposal of wrongfully removed cars.

Even in the state of sale, the large finance company generally does not record unless the transaction is over $500. Although the fees are small, the number of transactions, together with the relative infrequency of claims by third parties, makes it more economical to set up a reserve against such losses where a third party prevails because of failure to record.

In many jurisdictions, certain liens are occasionally created by statute, generally for the protection of landlords and garage owners or mechanics. These statutory liens have occasionally been seriously abused, especially in the case of garage liens. A purchaser about to default will turn the car over to a garage which will put in an exorbitant bill for repairs or storage,[156] perhaps sufficient to cover the buyer's equity. Under some statutes mechanics' liens are given priority in full or to a certain amount even though the finance company has recorded. In states where the statutes are silent as to the priority of the mechanic's lien, a majority of courts refuse to sanction the extension of the favored position of the lienor, and subordinate his claim to that of the finance company, unless it has consented to the repairs.[157]

[153] Mercantile Acc. Corp. v. Frank, 203 Cal. 483, 265 Pac. 190 (1928); Goetschius v. Brightman, 245 N. Y. 186, 156 N. E. 660 (1927); JONES, *op. cit. supra* note 51, §§1149-1161. Section 14 of the Uniform Conditional Sales Act provides for refiling within ten days after notice of removal. The removal must be permanent. Hare & Chase, Inc. v. Tomkinson, 102 N. J. L. 499, 129 Atl. 396 (1925); Forgan v. Smedal, 203 Wis. 564, 234 N. W. 896 (1931).

[154] WILLISTON, SALES, §339; Note (1928) 41 HARV. L. REV. 779.

[155] "The operation of the Texas doctrine illustrates its inconvenience. It appears to be a regular course of business for a swindler to buy a motor car on credit in California, or elsewhere, drive it into Texas, and sell or pledge it there. The original seller is helpless in the face of this practice; and Texas will doubtless continue full of willing *bona fide* buyers." Beale, *Jurisdiction Over Title of Absent Owner in a Chattel*, (1927) 40 HARV. L. REV. 805, at 810.

[156] There seems to be no distinction made between a lien for repairs or for storage. Wolfman Co. v. Eisenberg, 116 Misc. 43, 190 N. Y. Supp. 259 (1921).

[157] For a discussion of this problem, see Note (1927) 40 HARV. L. REV. 762. Cases are collected in Notes (1922) 20 A. L. R. 249, (1924) 30 A. L. R. 1227. The cases denying the mechanic's lien a priority when the finance company has recorded do not agree where there has been a failure to record.

The landlord's lien is more usually encountered in respect to the dealer, who is keeping cars in storage, than to the purchaser, whose car is on the street much of the time. While on the street it is not subject to the landlord's lien and may be repossessed. In the absence of statutory priority, the landlord, as in the case of mechanics' liens, will not generally prevail even though the finance company has failed to record.[158]

A perplexing problem is posed by the conditional sale of goods which are to be attached to realty in such manner as to fall within the legal category of fixtures.[159] If the realty is subsequently sold or mortgaged, will the reservation of title in the conditional seller prevail as against the claim of the buyer or mortgagee of the realty? If the latter has notice of the conditional seller's claim, the reservation will be protected, but as to whether recording of the conditional sales interest gives such notice and as to the effect of lack of notice, the decisions are in conflict.[160]

Certainly the recording acts have not fulfilled adequately an avowed intention on the part of their draftsmen to protect innocent third parties as well as the security interest of the seller or finance company. As to the automobile, a potential answer to most of the difficulties lies in a systematized use of the certificate of title now provided for in some states under motor vehicle registration acts. In almost every state where adopted, these acts are held to be aimed merely at prevention of theft rather than to serve the purpose of a recording act.[161] In some states, however, the inscription of the lien or encumbrance on the certificate of title and its retention by the seller affords protection against creditors and purchasers.[162] With this certificate of title goes a registration certificate to be carried by the purchaser, which indicates his rightful possession, an aid to checking stolen cars. The certificate of title system, if uniformly adopted throughout the United States, with provision for recording the lien or encumbrance on the certificate to be retained by the seller (or finance company) until payment, would constitute an easy method whereby prospective subpurchasers or creditors could ascertain immediately whether the possessor's title was unencumbered. In addition to keeping a record of car owners, the liens should also be listed by the state department issuing the certificate, assuring a check on the issuance of duplicate title certificates, supplementing the existing criminal provisions which, though stringent, mean little to the dishonest car purchaser.

Under the broad language of a few recording acts, the mechanic's lien would be protected. JONES, *op. cit. supra* note 51, §1122.

[158] Snyder v. Collins, 184 Iowa 122, 164 N. W. 624 (1917); Comm. Credit Co. v. Vineis, 98 N. J. L. 376, 120 Atl. 417 (1923) Beebe v. Fouse, 27 N. M. 194, 199 Pac. 364 (1921). See, in general, (1935) 3 DUKE B. ASS'N J. 27.

[159] What constitutes a fixture is a question which has been productive of much litigation. The goods must be so attached to the realty as "to become a part thereof," to use the phrase employed in Section 7 of the Uniform Act, but they must remain "severable without material injury to the freehold." If the goods are not so severable, the attempted reservation of title fails.

[160] For a discussion of this problem, see BOGERT, *op. cit. supra* note 67, at 97-107.

[161] Note (1932) 8 NOTRE DAME LAWY. 97.

[162] See, *e.g.*, VA. CODE (Michie, 1930) §2154 (39) l.

PRACTICAL ASPECTS OF SOME LEGAL PROBLEMS OF SALES FINANCE COMPANIES*

Joseph G. Myerson†

Mr. Adelson's article indicates a careful study of available literature and no substantial exception may be taken to its conclusions which accurately reflect the law and practice to which they are addressed. It is apparent that in recent years a vast number of cases have been reported involving the instalment contract. What does not appear, however, is that there were even a larger number of cases tried in the lower courts which did not reach the higher courts and so are not reported. Analysis of this great volume of litigation and the large amount of literature on the subject discloses that there is room for improvement in the law both by way of correction of existing statutes and by way of enactment of new legislation. Such cases, too, have engendered a practical approach to some of these problems which may be of interest.

Repossession

A prolific source of dispute and misunderstanding is the matter of repossession after default. We may start with the presumption that the legitimate finance company does not repossess equipment except as a last resort. If he has indicated a desire to continue his payments and the moral hazard is reasonably favorable every opportunity is given to the defaulting purchaser to make his payments. This may take the form of rewriting the schedule of payments for the remaining balance due under the contract or it may consist of a definite extension of time for particular instalments, or the postponement of several payments until a later time, generally after the last payment has matured under the contract as written. But where the purchaser is chronically in default month after month, where there is a reasonable suspicion of conversion hazard or where it is evident that a purchaser for one reason or another, such, for example, as loss of employment, definitely will not be able to make his payments, repossession will in all probability ensue. Here the representative of the

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finance company must determine whether it is economically sound to permit a defaulting purchaser to continue in possession, regardless of importunities which frequently may quicken his sympathy. It is hard to deprive a man of property for which he has sometimes paid a substantial amount of money—even though compensated for, at least in part—by the use of the property prior to the loss of possession.

It is a happy circumstance of repossession experience that in the great majority of repossessions without legal process there is a voluntary surrender of the property to the finance company. Not infrequently a purchaser who is unable to continue his payments drives the car to the place of business of the finance company and invites or requests repossession so that he may be relieved of his responsibility of further payments. Of course, it does not always follow that such a voluntary surrender discharges the obligation, for in those states where the law does not require an election of remedies, the car is sold either according to the requirements of statute or according to the provisions of the contract, and if the purchaser is financially responsible he may be followed for the deficiency. In many cases, however, of voluntary repossession the purchaser signs a waiver of statutory resale of the automobile and consents to a private resale, in consideration of which the holder of the contract releases the purchaser from all further liability.

But where the owner does not voluntarily surrender the property, what is the practice? Of course, if repossession may be had without resort to legal procedure it is desirable, from the point of view both of the holder of the contract and of the purchaser. The purchaser benefits because any expense which is involved in the repossession or litigation is charged against the account, resulting in a larger deficiency, for which action may subsequently be brought. Replevin or claim and delivery action is costly. We note that Mr. Adelson refers to the cost of these proceedings as ranging from \$2.50 to \$7.00.[1] More often the costs will run substantially beyond \$7.00. The plaintiff is required to post a bond and it is the practice (of the larger companies at least) to furnish a surety company bond rather than the personal bond of an officer or employee. The minimum premium is \$10.00 except where the property is valued at less than \$250.00, in which case a premium rate of \$5.00 is sometimes available. The statutory fees of the sheriff are generally not very high and perhaps from \$5.00 to \$7.50 would cover except that in practice it has been found that many sheriffs or constables will not give adequate or satisfactory service for the statutory fee, and a gratuity of \$5.00 or \$10.00 is frequently necessary if proper attention to a writ is to be expected. Add to this the attorney's fees and it becomes apparent that replevin proceedings are an expense to be avoided if at all possible.

Practically all states permit repossession of the property covered by the contract by self help, provided the repossession can be effected without breach of the peace. Despite the protection thus afforded by law, repossession by self help occasionally creates troublesome situations. Great care is exercised by the finance companies that

[1] See Adelson, *The Mechanics of the Instalment Credit Sale*, *supra* at p. 236.

no right of the purchaser may be invaded. Detailed instructions are given to company adjusters or representatives advising them specifically what they may or may not do. They are told, for example, that they may not break into a garage or other enclosure; that if the purchaser makes objection to the repossession the attempt to repossess must be abandoned forthwith, so that the possibility of a physical encounter is eliminated. While it may be that mere objections or protests of the conditional purchaser do not make an otherwise rightful taking wrongful, the finance companies have felt that taking of property in the face of objection or protest so closely approaches a breach of the peace and may so readily be expanded into a serious situation that, as indicated, the instructions are to abandon an attempted repossession under such circumstances; the exercise of force is at all times forbidden to a company adjuster. This does not mean that force is not sometimes exhibited, but the force is in the direction of purchaser to adjuster rather than adjuster to purchaser. Only a very few instances have come to the writer's attention over an experience of twenty years where purchasers have claimed that an assault was made upon them by a company employee and in each of these cases, thorough investigation indicated that the purchaser, and not the adjuster, was the aggressor. In one case, where an adjuster was arrested for such an alleged assault, he was discharged and completely exonerated, and the complaining witness, the purchaser, himself held on a charge of assault.

It will be seen then that the responsible finance company makes every effort to see that repossessions are peaceable, not in any restricted technical sense, but peaceable as the layman understands that term.

Where trouble is anticipated, even in the case of a repossession to be accomplished through the medium of a court writ, adjusters have been instructed, and make it a practice, to ask a local police officer to assist. Sometimes this does not work out, as in one case where a purchaser refused to get out of an automobile and a police officer standing by told the adjuster to go ahead and take the machine with the purchaser in it. Fortunately, the adjuster had too much good sense to follow the police officer's instructions. On the whole, it has been found helpful only in the occasional case to have a police officer present at the time of repossession. It would be most unfortunate, however, if the presence of a police officer were in all cases to be required. It is embarrassing for an honest citizen to have a police officer involved in his affairs and since it is only the exceptional case in connection with which the presence of a police officer might be advisable, it is evident that such a requirement is unnecessary and would do more harm than good.

Repossessions are reported to the Police Department promptly, especially in the large metropolitan sections. A purchaser whose car is repossessed from the street may report it as a theft, and it is a relief to him and to the Police Department when such report is made that the Police Department already has received a record of the recapture of the car from the holder of the contract, so that the machinery for

recovering stolen automobiles is not needlessly put into motion. The police are also notified in the case of repossession of an automobile in which personal property may be found. This, however, is done only where the purchaser cannot be located promptly and the property returned to him. Scrupulous investigation is made of all claims for loss of personal property. The finance company of course does not want to take property belonging to the purchaser and equally important, it wants to discover the fact if one of its employees is dishonest and takes such property without reporting it. In only one case out of all of these was it found that the purchaser's claim was well founded. In that case restitution was made and the adjuster was discharged. All other cases were resisted to the point of defending litigation, in which except in one instance, the fraudulent nature of the claim was disclosed.

Repossession having been made a purchaser may generally redeem his automobile upon payment of the delinquent instalments and the actual expense of repossession. In figuring these repossession expenses the purchaser is not "soaked," but a reasonable charge is made covering actual disbursements and the adjuster's time. If the account has been a bad one, however, the purchaser may not have the car upon payment of the delinquent instalments, but payment of the full outstanding balance is required. This, however, is not usual, and only where the delinquency is quite aggravated or the situation involves a condition of "insecurity" do the reputable companies insist upon payment in full.

It will be seen from all of this that the holder of the conditional sale contract is zealous to see that the purchaser who finds himself unable to meet his instalments promptly is given every opportunity to keep his property and that every effort is made to avoid even a semblance of abuse.

GARAGE LIENS

Incidental to this question of repossession is the problem of garage liens. As has been indicated in Mr. Adelson's article,[2] many states give some degree of priority to the lien of a repair or storage man over the lien of a conditional sale contract. The honest garage lien presents few difficulties. It is either paid or adjusted, depending on circumstance. There has, however, especially in the large cosmopolitan centers grown up what may be called the garage lien racket. Here the garageman who is given a limited priority, as for example in New York, where the priority is for services and materials furnished within a thirty day period,[3] has learned to avoid the limitations of the law by "faking" his bill. If he has a legitimate bill running over a period of more than thirty days he will make up a false bill putting all of the items in during the thirty day period, indicating perhaps a "fake" repair or an excessive use of oil and gas during that period to make up what he is not entitled to under the law. Frequently garage bills or claims are made up out of the whole cloth, or are "grossly exaggerated," as for example in *C. I. T. Corporation v. Solomon*.[4] In such

[2] *Id.* at p. 242.

[3] N. Y. CONS. LAWS (Cahill, 1930) c. 34, §184.

[4] 152 Misc. 833, 273 N. Y. Supp. 563 (1934).

cases the holder of the conditional sale contract must be alert if he is to avoid paying fraudulent garage bills. A physical examination of the car does not always assist, because a smart repairman can make it appear that he has dismantled and remounted a motor or rear end when in fact he did nothing more than remove a few bolts and wipe away some grease.

Where the holder of the contract is convinced that the garageman is claiming more than he is entitled to (and this is likewise true where a garageman refuses to give the car up to the holder of the contract, even though he is offered the full amount of his bill), it has been found helpful to make written demand upon the garageman for possession of the car accompanying the demand by a legal tender of such amount as the holder of the contract believes the lien holder is actually entitled to receive. The written demand gives the garageman a reasonable opportunity, forty-eight hours or seventy-two hours, as the circumstances may indicate, to determine whether or not to honor the claim made for the car and offers indemnity against other claimants. If this demand does not result in release of the machine replevin may be brought against the garageman. It has been held that under such circumstances (the court finding that the amount of his actual lien as adjudicated was tendered to the garageman either with or without an excessive claim having been made) he loses his lien and his refusal to give the car up amounts to a conversion of the property.[5]

While this procedure is helpful in some cases it has been found that a coldly practical attitude toward the garageman and "speaking his own language" are the best means of avoiding heavy assessments in this direction.

MISUSE OF AUTOMOBILE BY PURCHASER

Of course, repossession is made not alone for default in payment, but sometimes for breach of some other provision of the contract. The provisions most frequently violated, necessitative repossession, are those against transfer of the property without the consent of the holder of the contract and the improper or illegal use of the automobile either for purposes of taxi or hire or for actual law violation, such as bootlegging or the carrying of narcotics.

The hazards in the use of an automobile for hire are so much greater than those in the use of an automobile for passenger purposes that the sellers must receive a higher financing charge on such sales. Where the purpose is concealed at the time of sale and the facts are later brought home to the holder of the contract prompt repossession will usually follow.

A recent hazard in connection with the use of cars for hire has been the development of the drive-yourself business. Some dealers made it a practice of selling to drive-yourself organizations concealing the true purpose by having individual employees of one organization or the other act as the ostensible purchaser. Sometimes

[5] C. I. T. Corp. v. Isham Park Garage, Inc., 134 Misc. 501, 235 N. Y. Supp. 163 (1929).

as many as fifteen or twenty automobiles have been recovered by various finance companies from single drive-yourself organizations in drives to eliminate this type of fraud.

The bootleg situation of course represents a real hazard. Unfortunately, the repeal of the prohibition amendment, instead of being beneficial to contract holders, has operated to their distinct disadvantage. To begin with, seizures of automobiles for violation of the revenue laws continue in substantial numbers despite repeal of the 18th Amendment. The National Prohibition Act, by Section 26,[6] provided in effect that a lienor who could prove to the satisfaction of the court that his lien on the automobile had been created in good faith and without any knowledge of the intended illegal use of the car was protected and could either have his property returned to him if it was appraised at less than the amount of the lien or could have the amount of the lien paid out of the proceeds of the sale if it was appraised at a higher figure. The full benefits of this provision were obtained by virtue of the decision in *Richbourg Motor Company v. United States,*[7] which in effect held that where a violation of the prohibition law was indicated in the circumstances surrounding the seizure, the Government was bound to proceed for forfeiture of the automobile under the provisions of Section 26 of the Prohibition Act and could not proceed under the provisions of the Internal Revenue Act sections,[8] which provide for an absolute forfeiture. Prior to that decision it had been the practice of the Government to proceed for forfeiture of automobiles under Section 3450 of the Revised Statutes,[9] a tax evasion statute the application of which resulted in absolute confiscation regardless of the good faith or innocence of a lienor or owner. With the repeal of prohibition, however, the law established by the *Richbourg* decision became a "dead letter," and the Government has been free to proceed under the Revenue Act, the only right of an aggrieved lienor being to apply to the Secretary of the Treasury for remission, pursuant to Section 709 of the Revenue Act of 1928.[10] Because of its interpretation by the Department, this procedure has proved utterly inadequate and unsatisfactory. As pointed out by Mr. Adelson,[11] the decision of the Secretary of the Treasury is not subject to review by the courts and no matter how arbitrary the decision of the Secretary may be, the decision stands. Under the statute, it is provided that the Secretary of the Treasury, on petition, may grant relief where a petitioner can show that he is free from wilful negligence in connection with the sale of the automobile which has been seized and forfeited. Interpreting this statute, the Secretary of the Treasury requires the petitioner to show that prior to the sale of the automobile he communicated with the law enforcement agencies and made inquiry as to the reputed bootlegging activities of the prospective purchaser.

[6] 41 Stat. 315 (1919), 27 U. S. C. A. §40.
[7] 281 U. S. 528 (1930).
[8] 14 Stat. 151 (1878); 26 U. S. C. A. §§1181-1182.
[9] *Ibid.*
[10] 45 Stat. 882 (1928), 26 U. S. C. A. §2709.
[11] See Adelson, *supra note* 1, at p. 230, n. 73.

When it is realized that in 1934 approximately 2,500,000 automobiles were sold to instalment purchasers, the impossibility of making such inquiry of the enforcement agencies becomes apparent, but nevertheless the interpretation stands, resulting in denial of relief in case after case involving a meritorious claim. These petitions and the inquiry as to the bona fides of the claimant are judicial or quasi-judicial in character and belong in the courts and not in the Department of the Treasury. It is hoped that legislation now before Congress will be enacted restoring to the courts the right to pass upon claims of this nature.

Confession of Judgment and Waiver Clauses in Notes

It has been observed by Mr. Adelson[12] that the form of note and instrument generally employed in instalment sales contains a confession of judgment clause and a waiver of exemption and homestead rights. As to the latter, the reputable sales finance companies seldom, if ever, enforce it. The clause is retained, however, because on rare occasions it may be found helpful in defeating the fraudulent effort of debtors to dispose of their property and thus prevent the satisfaction of claims against them. Our own company has taken advantage of this waiver clause on only two occasions that the writer can recall, both involving instances of that kind. By and large, the consideration given to the debtor by the sales finance company goes beyond the exemptions granted him by law, and not infrequently the larger finance companies voluntarily write off and accept as losses open balances which might perhaps be collected if the contract holder had availed itself of all of the rights and remedies afforded by the contract.

As to the confession of judgment clause, this likewise is a defensive rather than an offensive device. It is true that instead of repossessing the property and suing for a deficiency the holder of a contract will sometimes enter the note for judgment and levy upon other property of the debtor, but this is the exception rather than the rule. The confession of judgment justifies its inclusion in the contract form for use in the case where the holder of the contract has reason to anticipate that the debtor intends to transfer property to defeat the rights of or defraud his creditor. In such cases the note is entered for judgment at once, thus creating a lien against the property and preventing its fraudulent conveyance. As Mr. Adelson points out,[13] most of the courts permit a judgment entered upon a note of this kind to be opened and a defense interposed when the debtor can prove that a bona fide defense is available.

Recording and Certificate of Title Legislation

It may be assumed that the essential purpose of a filing or recording statute is to prevent the fraudulent transfer of property held subject to an encumbrance. The filing laws, however, are so ill-suited to our far-flung commercial activities that this purpose of the statutes fails utterly, and this is especially true in the case of auto-

[12] *Id.* at p. 223.

[13] *Id.* at p. 224, n. 31.

mobiles. Most filing statutes require filing or recording in the place of residence. Specifically the filing may be required in the town where the purchaser resides or the county seat of the county where he resides. In the one case there may be as many as two thousand individual filing places in a state, in the other, as many as one hundred and fifty. Surely a person endeavoring to buy an automobile should not be required to check the records in all of these places; yet, only such a comprehensive search would be effective, for while the fraudulently-minded conditional purchaser may actually reside in one county and a contract be filed in that county, nevertheless when selling the car he will give his residence as at some other point (from which he has falsely registered it) and there of course no filing will be found.

To meet modern conditions central filing of automobile contracts has been developed. In the State of California, which is a pioneer in this type of legislation under the able sponsorship of J. Allen Davis, Counsel for the Automobile Club of Southern California, provision is made for the filing of automobile chattel mortgages with the Division of Motor Vehicles.[14] This makes it easy for one who wishes to buy a car to check the records at one central point and prevents the perpetration of fraud through concealment of actual residence.

A logical development of central filing is the coupling of that provision with the certificate of title. The certificate of title has been developed in recent years as an anti-theft device. Potentially it is far more effective as a preventive measure than is the Dyer Act[15] as a remedial measure, and if the law were adopted in all of the states interstate traffic in stolen automobiles would virtually disappear. The mechanics of the Certificate of Title Law are simple. When the owner of an automobile registers his machine he also applies for and receives a certificate of title. The registration gives him the right to run the machine on the highways of the state, whereas the certificate of title indicates his right of ownership and possession. The certificate indicates encumbrances and liens so that when a man wishes to sell his car and exhibits his certificate of title for that purpose the purchaser is at once put on notice that the car is subject to the indicated encumbrance. However, this system does not prevent fraud. A purchaser may apply for a clear certificate of title, concealing the lien which consequently will not appear on the face of the certificate, and may use the clear certificate to persuade a victim that the car is unencumbered. If as a matter of fact the car is held under a contract filed in the office of the statutory recording officer, the lienholder will generally prevail. If, however, the filing, as suggested below, were with the officer who issues the certificate and who co-incident with the filing would as a matter of course indicate the lien on the certificate, such frauds would be made impossible.

For this reason it has been urged that in addition to the notation of the encumbrance on the certificate of title the Bureau of Highways or such other department as

[14] CAL. GEN. LAWS (Deering, 1931) act 5128, §45¼.

[15] 41 STAT. 324 (1919), 18 U. S. C. A. §408.

may have control of certificates of title act as a central filing or recording point of contracts affecting automobiles. The importance of this problem was recognized by the Fourth National Conference on Street and Highway Safety in May, 1934, and in its most recent revision of the Uniform Certificate of Title and Anti-Theft Act there were included sections 64 and 65 which provide for such central filing and which make filing under any other existing state statutes unnecessary.

We look forward to the time when this uniform legislation will provide not only certificates of title for all of the states, but also the central filing provision. When that time comes dishonest contract purchasers will find it impossible to victimize the gullible by selling automobiles they do not own.

THE DISTINCTION BETWEEN SALES AND LOAN FINANCE COMPANIES

The relationship between the "finance company" and the consumer public has been misunderstood. Probably the underlying reason is due to the fault of neither but to the presence of a third factor, to wit, the loan company. In this article frequent use has been made of the term "finance company." It should be understood that this term refers to "sales finance company" as distinguished from "loan finance company." The sales finance company purchases from the seller of a commodity the contract or time payment document given to secure the unpaid balance. The loan company makes a direct loan to the owner of a commodity who may be obtaining the loan because of family emergencies or pressure of debts; or the borrower on occasion may be a purchaser obtaining the loan to pay a balance due on a contract held by a sales finance company which for reasons suggested above, may be requiring payment of the full balance following default. It is obvious that whereas the sales finance company acquires the contract of a consumer believed to be a solvent risk who may be expected to pay his obligation as he contracts to pay it, the loan company transacts its business with a necessitous borrower, knowing him to be such. It follows that the collection methods employed by the two types of companies are distinct; inherent in the loan company situation lies the possibility of collection practices which lead to resentment and complaint on the part of the borrower. These complaints, by reason of ignorance of the distinction between sales finance companies and loan companies, and also because many of the latter masquerade under a false title, are accepted by legislators and the public as being directed in a broad sense against "finance companies." As a result the sales finance company suffers for the dissatisfactions arising out of the nature of the business of the loan company.

Freedom of the operations of sales finance companies from abusive practices is due to a combination of factors. First is the circumstance that these companies (this is true of all of the larger or national companies and is generally true of the other companies) have been established for many years, were organized on a sound business and ethical basis, and are controlled by business men who from an inherent

sense of social responsibility properly conduct themselves toward those with whom they transact business. A second circumstance which leads to the high plane upon which the business is conducted is the fact that there are relatively few defaulting purchasers; the type of person who buys a commodity involving a substantial expense, is apt to be one in whom a proper course of conduct strikes a responsive note.

A third factor is that the sales finance companies perform an important function in helping move the product of the manufacturer and in facilitating the success of its sales organization. The finance company is not part and parcel of the organization which makes the sale, but the sales finance industry is regarded as a virtual arm of the manufacturing and selling industry. The sales finance company is interested in getting the merchandise sold and in keeping the customer satisfied. The loan company is neither motivated nor restrained by any such considerations. That being so, regardless of the extent to which the sales finance company is prompted by an inherent regard for the rights of those whose obligations it holds, it must in the performance of its function as the financial "adjunct" to the manufacturer and merchant preserve for them the good will of the buying public.

BETTER BUSINESS BUREAU ACTIVITIES IN AID OF THE TIME PURCHASER

Edward L. Greene*

Consumer complaints made to Better Business Bureau executives against dealers who sell on time payments are the result of various causes. The most common complaints are against dealer deception—sometimes downright trickery. Occasionally it is impossible to show that the law has been violated, yet nevertheless, from our experience, we know that some dealers have set out deliberately to trap their customers. Thus enmeshed in legal contractual relationships, the victims must have assistance to avoid serious losses. Unfortunately, they are frequently dependent upon the questionable leniency of ruthless schemers which is, to say the least, forcing them into accepting hard bargains.

Of course, there are some participants of time payment purchases who find themselves in trouble because of their over-reaching their ability to meet instalments as they come due. Some complainants are welshers who attempt to obtain the services of the Bureaus to pull their chestnuts out of the fire.

It is well to bear in mind, moreover, that in any discussion of the practices involved in time payment sales plans there are countless instalment sales that are mutually satisfactory to buyers and sellers. We are without the facilities to make a careful survey of unfair time payment practices which affect the consumer, but from what we have learned from consumer complaints we believe that there is ample need for greater consumer protection.

Generally speaking, Bureau executives report that most of the complaints they receive involve the automobile, automobile accessory, furniture, radio and jewelry businesses. While there is no doubt that unfair transactions occur in the sale of new automobiles, it seems to us that practices in the sale of used cars are more serious.

Complaints indicate that many people do not understand that there is no standard financing charge. Where buyers have questioned the interest charges, the salesmen are known to have replied that they are the usual nominal charges. Later, the buyer discovers that they are excessive. Some used car buyers are induced to sign time payment papers in blank. Of course, this carelessness leaves them wide open for any

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chicanery that unscrupulous dealers can devise. In some instances used car dealers advertise "No Down Payment" but require chattel mortgages on furniture before consummating sales.

One Bureau executive reports: "Our primary complaints in this field have been against automobile accessory and radio dealers taking liens on cars and then attaching them. One case which is not typical, but which illustrates the practice, was of a colored boy who owed $2.00 on a tire for his car. His car was attached and he was forced to pay a $15 repossessing fee, the balance on the tire and a $2.00 storage fee for his car."

Another Bureau executive reports: "Some cases have come to our attention wherein the buyers were quoted a definite price as a financing cost only to find upon completion of the sale that the total financing charge was sometimes two or three times as much as what had been represented to them. When the purchasers learned of these discrepancies and refused to make further payments, the financing companies then went through the regular procedure of repossessing. The most unfortunate part of some of these cases has been that the purchasers had signed conditional bills of sale before the terms were written into their contracts. One dealer had a further hold on his victims even if his prospects did not go through with the conditional bill of sale. Many complainants alleged that when they had old cars and called at the dealer's place of business to try out the cars they were contemplating purchasing, they were asked to leave their old cars while they tried the dealer's. At the same time, they were asked to sign a paper which was represented to be a receipt to show they were trying out the dealer's cars but which actually turned out to be releases on their own cars. During the period they were testing the dealer's cars their own cars were removed, and when they complained the dealer pointed out to them that they had signed releases on their cars and in some cases had actually signed orders to purchase cars using their old cars as down payments."

We have a report on a tire company that makes short-term contracts and renews them for a fee. Some people have complained that after several years of paying on their contracts they still owe more than the original purchase price.

We are advised that furniture dealers are exercising a more careful check-up before they will sell on time payment plans. The reason for this care is due to losses resulting from repossessing. However, when credit has been established some furniture dealers are not above trying sharp practices. A case in point is of a buyer who contracted to pay $1,000 for some furniture. When the amount due was paid the dealer induced the customer to buy a $100 radio. Before the radio was paid for the buyer lost his position and was unable to continue the instalments. The buyer claimed that, unknown to him, the purchase of the radio was placed in the same account as his paid up furniture, and for failing to meet instalments on his radio, he was threatened with a loss of his household furniture as well as his radio.

Interest charges sometimes amount to much more than is claimed by the dealer.

A case reported involved the purchase of a piano for which the buyer contracted to pay $545. He was told that an interest charge of 6 per cent would be made. But when he started paying the "accommodation" charge, it was for $2.48 a month until he completed his contract. He paid this charge of $2.48 a month for three years, sometimes missing a payment on the principal but always paying the carrying charge. At the time the case was reported, the customer had been paying on his contract for three years and had reduced the principal to $71. But, of course, the $2.48 a month financing charge continued.

Instalment houses as a general rule advertise "Easy Credit Terms." Many prospective customers are induced to make down payments before their credit is established. Unscrupulous dealers who so advertise and who subsequently refuse to extend credit have been known also to refuse to refund the down payments. Instead, they insist that the down payments be traded in on cash purchases. Victims of this scheme are forced to buy something that they can get along without and what they do obtain for their money is in most instances excessively priced. In one such case the proprietor of the store was prosecuted on the charge of larceny by trick.

In states where employees are not protected against the abuses applicable to assigning their wages, they are likely to be exploited.

The wage assignment made for goods has, in the past, been used in a proper manner by a number of concerns. Unfortunately, it has also been used by a type of dealer relying upon high-pressure selling methods and questionable practices to extract the "last dollar possible" from a customer. These assignments are usually made in haste, the purchasers frequently believing that they are merely signing for the delivery of the goods. They may not know the seriousness, nor appreciate the importance, of an assignment of future wages. They are often signed by persons misled by verbal statements of the salesman which are not included in the printed agreement; and the agreement is frequently printed in such small type as to require a magnifying glass to read it, and to understand the complicated phrasing would require a "Philadelphia lawyer." Then the assignment is kept in escrow until its use is needed for collection purposes. In any case, where dispute arises in regard to the goods delivered by the dealer, the purchaser is practically helpless. He must meekly submit to unjust treatment, or face the possibility of his employer being called upon to pay on the wage assignment.

Whenever notices of an assignment are served, many employers have promptly discharged the employees without investigating the circumstances connected with the cases. They resent being compelled, without their knowledge and consent, to pay a third party one-quarter of an employee's weekly wages. The system also involved considerable expense for the employer. The assignment ran against "any person by whom I am now employed or may be employed." It required no acceptance by the employer; he had no discretion and was obliged to pay. To avoid the duty of being a compulsory bill collector, he often dismissed the employee or told him to pay the

dealer direct. Thus the employee had little chance of successfully resisting unjust demands by the holder of an assignment.

There are a number of cases on record with the Better Business Bureaus where customers signed wage assignments in connection with a purchase of furniture, etc., on the partial payment plan. In these cases of complaint, it is set forth that they failed to secure the furniture which they purchased, but that cheaper and inferior merchandise was substituted. When they refused to complete their payments, and made complaints, they were threatened with wage assignments unless payments were made in accordance with the terms agreed upon. Many employees, fearful of the attitude of their employers, have, in this way, been victimized by unscrupulous dealers.

The person who received the assignment knew its value. It was not only good security, but was a club over the head of the man who gave it. Employees submitted to unreasonable terms, to unfair treatment, and to additional costs, because of their fear of the attitude of their employer if a notice of the wage assignment was served on him. Consequently, a family in such a predicament paid excessive and exorbitant charges for credit out of all reason to the actual cost of this service.

The unfair use of the wage assignment is confined to a group of unscrupulous dealers who have continued in business by abusing the confidence of the public, chiefly workers of small means. The financial condition of the people involved, and the attitude of some large employers, indicate that the remedy did not lie in any court procedure. In fact, the damage was caused before an attorney could be employed or court action commenced.

While no doubt there are reliable dealers who include an assignment of wages in their instalment sales contracts, the use of such contracts by scheming dealers often leads to misfortune and great grief to their victims. The wage assignment also reduces the necessity of credit checking when the prospective buyer is employed in a position that indicates regular employment. Consequently, most of the unscrupulous dealers direct their claims and efforts to this class of wage-earner.

There have been many schemes devised to sell jewelry. One of the most vicious reported to us was practiced by salesmen who induced small salaried employees, while at their places of employment, to take cheap jewelry home for "examination." The salesmen stated that if it was not satisfactory they would return the following week and take it back. They required the recipients, however, to sign "receipts," which were in fact bills of sale, and wage assignments to be served on their employers in the event of failure to pay. The salesmen never returned and no effort was made to collect directly from the buyers. In due course, the wage assignments would be served on the employers.

When customer complaints involving time payments are brought to the attention of Bureau executives, they proceed to investigate all the circumstances leading up to the complaints. The Bureau manager acts as a neutral third party mediating the

difficulty so as to try to protect the interest of the other two. When this procedure is not successful and the Bureau manager believes the customer's complaint is justified, he may refer the customer to the Legal Aid Society or to some law-enforcing body, whichever, in his judgment, will prove more helpful.

It is, of course, customary for Bureau executives to keep records of complaints brought to their attention. This practice will usually provide the evidence to point out unscrupulous dealers. The accumulated evidence thus obtained will be presented to a law-enforcing body. It is also the practice of many Bureau managers to issue publicity prepared to reach the public which names unfair dealers and outlines the practices which are detrimental to public interest.

The Better Business Bureaus, of course, are amenable to the law and consequently must act in accordance with the law. But there are numerous occasions when adjustments are obtained by Bureau executives for parties to complaints that are the result of misunderstandings. Complaints cleared up by this procedure are helpful both to the public and honest dealers.

Bureau executives examine complaints from the customer viewpoint because it is obvious that if a dealer deceives the public he is likewise using unfair competition. Unfair competition might be difficult to prove in some cases of fraud, but in businesses where time payments are used, this difficulty is not a factor.

The interpretation of the Retail Code which requires that advertising offering time payment sales plans must also include a notice of financing costs when they are charged,[1] has proved very helpful in eliminating complaints in those communities where the Retail Code is enforced.

This tends to demonstrate that, if the public is put on notice that financing charges must be paid if purchases are to be made on time payment plans, customers will enter into such transactions with a better understanding of their responsibilities and exercise a greater degree of self-protection, and make better credit risks for those with whom they do business.

Bureau publicity is distributed in bulletins, newspaper releases and radio broadcasts. The publicity urges consumers who believe they have been cheated to report their experience to the Bureau. In communities where this program is actively carried out, unscrupulous dealers become known and in many instances have been forced to change their tactics. Overloading charges, however, may not be discovered if they are adroitly sold, and doubtless there are many unfair and deceptive sales that are made that Bureau managers never hear about.

[1] The Code of Fair Competition for the Retail Trade provides: "No retailer shall use advertising . . . which . . . misrepresents . . . credit terms." Art. IX, §1 (a). The following official interpretation of the application of this provision to the advertising of time payment plans was issued June 26, 1934. "It shall be an unfair trade practice, under Article IX, Section 1 (a) of the Code for a retailer to advertise or offer for sale any merchandise with a statement or representation that the merchandise may be purchased on any deferred payment plan, of whatever nature, without charge for such deferred payment, interest, services, privilege, or other comparable designation, when in fact discounts from quoted or marked prices are given on identical goods sold for cash or when differentials between prices for cash and prices for installment payment are quoted, marked, or made available for identical merchandise, at any time during the period in which such merchandise is on sale or offered for sale." N. R. C. A. Rev. Bulletin TP-7.

DEVICES FOR LIQUIDATING SMALL CLAIMS IN DETROIT

Rolf Nugent*

The problem of the small debtor has existed in all civilizations which have recognized private property rights. It antedates by many centuries the beginnings of instalment selling. But the current problem of the small debtor in the United States cannot be dissociated from the consequences of easy-payment merchandising. Debt is an essential by-product of an instalment sales contract. The growth in the number of such contracts during the post-war period has tended to increase the extent of the problem of the impecunious debtor, while the use by instalment merchants of powerful collection weapons has tended to increase its severity.

The city of Detroit has had more than its share of the problem of the small debtor. This accounts perhaps for the fact that the most elaborate and, we believe, the most significant experimentation with remedies has occurred in that city.

The collapse of business and finance in Detroit following the precipitate decline in automobile production between 1929 and 1932 has been so widely publicized that it needs little exposition here. Its effect was to wipe out most of the asset items on the balance sheets of Detroit's industrial wage-earners and to leave on the liability side of these ledgers deficiency judgments on foreclosed homes, building lots, and repossessed automobiles, and unpaid bills for goods and services which had been contracted in more prosperous days or accumulated during periods of unemployment.

Two other circumstances contributed to the severity of the problem. The first of these was the seasonal character of employment in Detroit. Not only the employes of the automobile industry itself but employes of those enterprises which supplied goods and services to automobile employes, felt the effect of the seasonal demand for automobiles. Even employes of public service companies, who usually enjoyed stable employment elsewhere, were subject to seasonal lay-offs following shut-downs in the automobile industry. The uncertainty of employment added to the seriousness of the small debt problem by making any promise of future payment unreliable, by creating misunderstanding between debtor and creditor, and by penalizing the creditor who did not enforce repayment by whatever device was at hand while the debtor was still on the payroll.

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The second circumstance was the severity of the Michigan garnishment law. By means of garnishment process, the creditor could attach 70 per cent of the debtor's wages if the debtor were single and 40 per cent if he were married, but not more than $30 and not less than $10 of a married man's current bi-weekly wages was exempt. Because of the maximum exemption and the fact that many workers in Detroit got less than five months' work a year, as much as 50 or 60 per cent of a married wage-earner's annual earnings might be taken by repeated garnishment. In periods of full-time work, the process tended to take all the surplus beyond living expenses which the debtor relied upon to carry him through lay-off periods.

Garnishment caused hardship to the debtor not only because it left him with an inadequate allowance to support his family, but also because it was extremely expensive and frequently led to his dismissal. The court charge for a judgment was $2.00 and for a garnishment order, $2.50. In addition, the debtor's employer might demand a show-cause order costing $1.00, before recognizing the garnishment order. A new garnishment order had to be issued and a new show-cause order could be demanded before each succeeding pay check could be attached. The largest employer of labor in Detroit maintained a rule (to which frequent exception was made, however,) that employes whose wages were garnished should be immediately discharged. Although it was unusual for other employers to discharge for a single garnishment, many considered a second or third garnishment to be sufficient ground for dismissing an employe.

Pressure for the development of more adequate facilities for debt liquidation appears to have come not only from those seeking to protect employe-debtors, but also from groups of creditors and from employers. Many creditors who were unwilling to resort to garnishment found that the debtor's means of payment was pre-empted by other creditors who had no such compunction. Employers favored the avoidance of garnishment because they were annoyed by the bookkeeping costs incident to it.

The Conciliation Division of the Detroit Common Pleas Court

The first and by far the most important effort to facilitate the liquidation of small debts was made by the Common Pleas Court for the city of Detroit. In October, 1932, by order of the presiding judge, a Conciliation Division was established within the court.

The purpose of the Conciliation Division, originally, was to attempt to settle without cost small claims by indigent creditors. All creditors filing claims were required to agree to abide by the settlement. Attorneys were not permitted to file claims in the Division. The maximum amount of any claim was limited to $35, but this could be increased to $100, in the discretion of the presiding judge, if the claim was meritorious and the creditor indigent. Actions pending or actions in which judgment had been granted could be transferred to the Division by consent of both

parties. The Division was authorized to arrange for partial payments by the debtor and to prohibit the issuance of any garnishment or attachment while the debtor complied with his agreement.

The Conciliation Division immediately began to receive and to arrange for periodic payments upon many claims by small landlords, boarding-house keepers, grocers, and individuals. The most frequent plaintiffs, however, were prevented from initiating actions in the Division because they could not meet the requirement of indigence. Since they could not use the facilities of the Division for initiating claims without cost, they preferred to rely upon the threat, and if necessary the execution, of garnishment orders to satisfy their judgments.

Judge Joseph A. Gillis, who has been in charge of the Conciliation Division since its inception, wrote of his efforts to arrange for partial payments on judgments as follows:

> It was brought to my attention in several hundred instances that workingmen, who had just returned to work and had accumulated several debts which had been reduced to judgment, had every pay garnisheed. I then attempted, as an experiment, to bring plaintiffs and defendants together, requesting the plaintiffs to accept a certain sum of money out of the defendant's pay and to waive their rights of garnishment. I soon found that in order to do this it would be necessary for the court to collect the money and impound the file in the case so that garnishment would not issue. In the months of November, December, and January, 1932-1933, several hundred agreements were entered into voluntarily, and it was noticed that in about 90 per cent of the cases defendants faithfully kept their word and made their payments, so that arrangements were satisfactory to the plaintiffs. However, in many instances, one plaintiff would refuse to stop garnishment proceedings, even though four other plaintiffs having judgments against the same defendant would agree, and many instances were found where defendants lost their positions because of a series of garnishments against them.

In coöperation with the Detroit Bar Association, Judge Gillis drafted a bill to extend the powers of the court to cover this situation. The bill, which applied only to the Detroit Court, became law in June, 1933.[1] It provided (1) that motions for partial payments on judgments might be made by either party to the action, (2) that the Court should fix the amount of such payments, based upon the debtor's wages, after a hearing, (3) that payments were to be made to the Court, (4) that writs of garnishment in execution of the judgment should not be issued while the debtor made the agreed payments, and (5) that upon failure of the debtor to make such payments the order of the Court would be set aside and the creditor might proceed with garnishment.

Although this enactment did not mention the Conciliation Division, it was convenient for the Division to continue to handle motions for partial payments on judgments. The number of motions for partial payments on judgments increased rapidly and these motions soon became the predominant part of the business of the Division. By February 1, 1935, 22,500 claims had been entered in the Division and payments

[1] Mich. Pub. Acts 1933, No. 125.

were being made through the Court on almost 5,000 current accounts. More than 90 per cent of current accounts represented partial payments on judgments.

The procedure of the Conciliation Division is simple and highly informal. A judgment-debtor who wishes to move for partial payments makes a certified statement showing the amount of the judgment, the name of his employer, the number of his dependents, and the amounts which he owes to other creditors. He is required to have his employer fill in a form showing the amounts recently paid to him in wages. The date of the hearing, which is always within ten days of the date of the motion, is set and the debtor is told to appear or to have some member of his immediate family appear for him. If the debtor has made motions for partial payments on several judgments, the Court sets the same time for all hearings. The motion is then entered on the docket and the creditor is notified of the motion and of the date of the hearing. Garnishment executions are immediately suspended.

Hearings are held four mornings a week and occasionally an additional hearing is held in the evening in order to accommodate debtors who could not otherwise appear. The creditor may appear in person, be represented by an attorney, mail a written consent, or permit the arrangement by failing to respond. At first most creditors appeared or were represented by attorneys. But more recently creditors appear or are represented only in unusual cases. The debtor appears in person or is represented by his wife. The Court calls first those cases in which attorneys have appeared.

Few of the usual rules of court procedure are adhered to. The Court attempts to ascertain the facts and determine the amount of periodic payments as quickly as possible. Many cases require only a few seconds to complete. In some cases, the creditor may challenge the debtor's statements; in others the Court asks questions of debtor or creditor. Involved cases are frequently postponed until those which can be handled quickly have been disposed of. Judge Gillis has a genius for getting to the heart of a debtor's difficulty in minimum time. Debtors and creditors are scolded and sympathized with impartially.

It is the policy of the Court to fix payments at approximately 10 per cent of the debtor's usual wages. Payments may be fixed at a lower figure if there are several judgments, or at a somewhat higher amount if the debt was long delinquent and the debtor appeared to have been careless in meeting it. Some creditors objected strenuously at first to the payments fixed by the court. But these objections have gradually diminished, partly because of the satisfactory results of the partial-payment plan and partly because of the uselessness of their objections. If debtors object to the payments, the Court asks, "How much would they get if they garnisheed?" The final admonition to all debtors is, "Don't miss your payments or they'll garnish your wages." Payments usually begin on the next payday following the hearing. The clerk of the Court makes a notation of each payment on the case record and the money is paid to the Court cashier. If a debtor is laid off, his payments are sus-

pended and he is instructed to reinstate his motion as soon as he is re-employed. Part-time work frequently adds complications to the procedure, but the Court makes a practice of reducing payments if the debtor brings in a pay check for a very small sum.

In recent months, the Court has been handling from 25 to 60 cases at each session. The recording of payments has become a burdensome job and the staff of the Court has been increased to 10 clerks. The routine work of preparing affidavits and explaining procedure to debtors is done by them. Fortunately, several speak Polish or Roumanian, and this is a great asset in dealing with debtors of these nationalities.

The Personal Receivership Act

Shortly after the enactment of the law which extended the powers of the Conciliation Division, a second bill was introduced in the Michigan legislature to facilitate the liquidation of small claims in municipal and justice courts in cities of more than 50,000 and less than 500,000 population. The bill was somewhat similar to a law which was enacted in Ohio several months earlier and apparently was inspired by this example. The bill was enacted in October, 1933, and the law is known as the Personal Receivership Act.[2] This act provided that a debtor might assign his future wages to the clerk of the court. The clerk was then to return 60 per cent of the wages plus $1.00 a week for each dependent child if the debtor was married and 40 per cent of the wages if the debtor was single. The debtor was required to file a certified statement listing his creditors and the amounts due to each. The amount withheld was then to be pro-rated among all creditors on the basis of the amount owed to each. The Court was to distribute money to creditors at least once every sixty days, or when the amount collected from a debtor reached $50. The charge for this service was to be 50 cents for filing the statement of debts, and 50 cents additional for each creditor listed.

Only one court in the environs of Detroit makes any considerable use of this device. This is the Municipal Court of Dearborn over which Judges Leo R. Schaefer and Lila M. Neuenfelt preside. By January, 1935, this Court had received 90 applications from debtors and had 78 current cases. Its practice is to notify the employer that the debtor's wages have been assigned to the Court, as soon as the debtor files his statement. Employers' deductions, such as hospital payments or the repayment of sums advanced for relief, are usually made before the check is sent to the Court. No hearing is held unless a claim is contested and contests are rare. Many debtors are sent to the Court by creditors, particularly by grocers, and by employers. If the debtor wishes to have his case dismissed, a formal notice of dismissal is sent out. The reason for most dismissals is that the debtor becomes discouraged by the amount of his debts and the heavy drain which the assignment makes upon his income.

Approximately $50,000 has been collected and disbursed by the Dearborn Municipal Court since October, 1933. The number of debts listed by each debtor ranged

[2] Mich. Pub. Acts 1933, No. 184.

from six to 23, and the total amount owed from approximately $200 to $2,231. The largest total debt was reported by a policeman who owed 21 creditors. His case was later dismissed and he went through bankruptcy.

Clyde Fulton, a Justice of the Peace in Highland Park, has made much smaller use of the Personal Receivership Act. This Court handled but four personal receivership cases prior to January, 1935.

The chief handicap to the extensive use of the Personal Receivership Act is its cost. The recording, pro-rating, and periodic disbursement of a large number of small items is exceedingly expensive and it is probable that small courts, which for budgetary reasons cannot expand their staff, will tend to discourage its use. The portion of each pay check taken by creditors, also, is large and if the debt is so great that the receivership must last for considerable time, debtors get discouraged by the heavy drain upon their incomes. A further handicap to the success of the Personal Receivership Act is the effect of its use upon the debtor's pride. Wage-earners are sensitive to the implication that it is necessary for a public official to handle their family finances for them. Most applicants for personal receivership came as the result of pressure by employers or creditors.

Informal Procedure in a Hamtramck Justice Court

A Justice Court in Hamtramck, a suburb of Detroit largely populated by Poles, has developed a third device for dealing with small claims. S. N. Grankowski, who took office as Justice of the Peace in July, 1934, considered using the Personal Receivership Act and finally rejected it because he believed that the debtor would be reluctant to meet its requirements and that expenses of administration would be prohibitive. He decided to handle partial payments informally as was done originally by the Conciliation Division of the Detroit Common Pleas Court. Since both the granting of judgments and the issuance of garnishment orders in execution of these judgments are in his hands, Justice Grankowski suspends garnishment in cases where the debtor asks to be permitted to make partial payments on a judgment. Informal hearings at which both debtor and creditor appear are held and the debtor gives a statement similar to that required by the Conciliation Division. The Court lacks power to do more than facilitate an agreement between the parties. Payments are determined by compromise and vary widely both in amount and in their relationship to the debtor's income, ranging generally between $1.00 and $10 bi-weekly. Some payments are made to the Court and others are made directly to the creditor.

As in the Conciliation Division, agreements are suspended during lay-offs and the payments are reduced by the Court if the debtor gets a "short pay." Sometimes the debtor fails to keep his agreement and the creditor is given a writ of garnishment. Usually payments are subsequently reinstated on the motion of the debtor. Roughly 300 judgments a month are granted by the Hamtramck Justice Court and about one-fourth of the debtors apply for partial payments. The amounts are fre-

quently small and repayment is generally more rapid than in the Conciliation Division. Little difficulty has been experienced in arranging settlements and there does not appear to be a need for further statutory authority. The personal relationship between most debtors and creditors in Hamtramck explains this situation in part. Creditors are generally small landlords, grocers, and butchers who have carried debtors while they were unemployed. Both debtors and creditors are usually Polish and have a relatively similar economic and social status.

Justice Grankowski believes that he would have more trouble in effecting agreements if automobile finance companies, instalment merchants, industrial banks, and small loan companies brought suits in his Court. Only one instalment merchant, a clothing company, brought any quantity of actions in the Hamtramck Justice Court in the past and it was always difficult to arrange settlements in these cases. The company has since failed.

Michigan Merchants' Credit Association

A fourth device for debt liquidation was developed by the Michigan Merchants' Credit Association. The principal function of the Association was to supply credit information to instalment merchants, industrial banks, and automobile finance companies who were members of the Association. As a means of preventing ill-will among employers and customers, the Association attempted to avoid garnishment for delinquent accounts by developing a collection service. The Association receives from its members lists of defaulting customers with the names of their employers at the time of making the contract. The Association sends these names to employers who have agreed to coöperate, and the employer returns it, checking the names which are still on his payroll. Form letters are then sent to each defaulting debtor, frequently through the payroll clerk at the place of employment, pointing out the possibility of legal action and asking that the debtor come to the Association's office to discuss his difficulties. When the debtor calls, his situation is reviewed and he is urged if possible to agree to make reasonable payments on the account. In return for the promise of periodic payments, the Association promises that the creditor will not garnish the debtor's wages as long as payments are made. The Association serves only as a means of contact between the employer, the debtor, and the creditor in the negotiation of an agreement. Payments are made directly to the creditor.

The number of cases handled by the Association is small. It began its activities in August, 1934. By February 1, 1935, 445 cases had been turned over to it by its members and of these only 171 cases resulted in agreements for future payments. The plan depends in large measure upon the willingness of employers to coöperate and the Association has gradually increased its list of coöperating employers. The number of cases handled and the number of cases in which agreements were effected have been increasing and it seems likely that this device will have a somewhat greater importance in the future.

Appraisal

There can be little doubt that these four devices have made a material contribution to the amelioration of the problem of the small debtor in the Detroit area. They have served wage earners by avoiding harsh consequences of garnishment; they have served employers by relieving them of the bothersome bookkeeping involved in payroll executions and by improving the morale of their employes; and they have served creditors by facilitating the liquidation of delinquent accounts in an orderly manner. Such accomplishments benefit the whole business and social life of the community.

Two agencies—the Conciliation Division in Detroit and the Justice Court in Hamtramck—have handled considerable numbers of cases, and in both instances a large proportion of these cases have been completed successfully. That these agencies should have developed to their present extent in spite of the difficulties which seasonal employment has thrown in their way is ample evidence that there is a real need for their services.

The work of the Conciliation Division has a special significance with respect to instalment selling, because approximately half of the cases handled by the Division involve instalment purchase contracts. In the early experience of the Division, sharp practice among plaintiffs who held judgments for instalment contracts was common. The Court frequently discovered that constables had made fraudulent proof of summons and that debtors were not aware of suits against them until their wages were garnished. Tricks to secure judgment by default were not uncommon. Frequently defendants, upon whom service had been made, were led to believe that repossession cancelled the obligation, and deficiency judgments were then taken by default and garnishment orders executed. High attorney's fees occasionally were added to judgments for very small sums. Some creditors attempted to collect "locating charges," excessive court costs, and excessive interest charges on delinquent balances. Repossessions and sales of repossessed goods were frequently abusive.

These are but a few examples of a long list of questionable practices which had crept into the business of collecting delinquent accounts. Judge Gillis frequently called instalment houses or finance companies by telephone to object to certain practices and to suggest that they be discontinued. The Court's objections and admonishments extended not only to practices with which it had authority to deal, but to general collection methods and even to the conditions of sale, over which it had absolutely no jurisdiction. The willingness of the Court to dig into cases in order to expose anti-social practices has had a very salutary effect upon the instalment selling and financing business. The more flagrant abuses have been practically eliminated and others have been reduced materially. The Court recognizes thoroughly the limitations of its legal authority, but its power for improvement by means of moral suasion and the fear of publicity is great. Here, then, is an experiment with the regulation of instalment selling, which in spite of its limitations has had a fair degree of success.

The same broad conception of its function is applied by the Division in giving advice to debtors. The Court frequently points out the usual cash price for articles which the debtor has bought on the instalment plan for a much higher price, and occasionally the Court's opinion on values is supplemented by an appraisal by a reputable merchant. Judge Gillis' unorthodox court-room technique is one of the real assets of the Division. His obvious personal interest in his cases and his freedom from procedural limitations has developed a relationship between the Court and the defendant which is rare except in certain European courts.

The experimentation with these agencies for debt liquidation in Detroit has more than local significance. Although the problem of the small debtor is unusually acute in Detroit, the need for similar facilities undoubtedly exists in other communities and perhaps in some degree throughout the nation. Without detracting from the credit which belongs to those who have labored to create these devices, it seems worth while to examine them critically in order to appraise their possible usefulness elsewhere. Like most other new devices, they have tended to adjust themselves to the necessities of each situation as it arose. There has been no experience that could be used as a guide, and little opportunity for advance planning or for careful considerations of public policy.

The pressure necessary to stimulate the development of these devices came, as we have already pointed out, from a combination of circumstances. These circumstances furnished not only the impetus for the initiation of these agencies, but also the conditions essential to their success. The mainspring of each of these devices is the willingness of the debtor to keep his promise to make regular payments, and it is unlikely that such promises would be kept generally if garnishment, in its present severe form, were not the penalty for default. As a recourse for the creditor after the debtor has failed to keep an agreement for reasonable partial payments, the severe garnishment privilege is perhaps justified. It should be remembered, however, that the garnishment law is state-wide and that many industrial communities in Michigan have developed no similar devices for partial payment. The existence of these Detroit agencies is in large measure dependent upon the continuation of a collection weapon which the legislatures of most states would reject as cruel. It follows also that similar devices would not be successful in communities which lacked similar penalties for default.

Although these debt-liquidating agencies have prevented garnishment in large numbers of cases, the number of such cases is still far exceeded by the number of garnishment executions. Even in Detroit, where the Conciliation Division handles approximately 1,000 motions a month, garnishments issued by the Common Pleas Court approximate 2,000 a month. Whether the garnishment law is not the essential element in ameliorating the small-debt problem in Detroit remains to be determined by a more careful study than we have been able to make.

Even the intensive effort given to partial payment cases fails in many instances

to solve the debtor's longer-term problem. Both the Conciliation Division and the Hamtramck Justice Court tend to meet the emergencies of the small debtor by arranging for the liquidating of one or, at most, several debts which have been reduced to judgment. Payments on judgments are frequently made at the expense of payments on other delinquent accounts or current obligations. The Dearborn Court, where the number and amount of debts listed by individual debtors is large, appears, on the other hand, to deal with the debtor's whole problem. But the very breadth of its approach hampers its success. If the debtor lists all his debts, the amount is frequently overwhelming and the period over which he must make severe sacrifices to meet his obligations is so long that discouragement in many cases is inevitable. The debtor has a simple recourse from such discouragement. He may go into bankruptcy and avoid both his debts and the hardships involved in repaying them. The number of wage-earner bankruptcies in the Detroit area has increased rapidly.

It appears to the writer that all of these agencies lack one function which is essential to a broad approach to the problem of the small debtor. One of the characteristics of this problem is that the aggregate amount of the debt in many instances is out of line with the ability of the debtor to pay. Unless these debts can be reduced to an amount which can be paid over a reasonable period without too great a reduction in the debtor's standard of living, final default will only be postponed and efforts to facilitate repayment will favor one creditor at the eventual expense of other creditors. The job which needs to be done lies somewhere between the functions of the bankruptcy court and the functions of the small loan company and the industrial bank, which have perennially handled the refinancing and refunding operations of the family.

The problems to be met in accomplishing debt adjustment are great. To suggest that the Detroit agencies tackle this job is to express confidence in their ability to succeed in a larger field rather than to criticize the excellent work which they are doing in a more limited one.

INSTALMENT SALE CONTRACTS IN THE DETROIT CONCILIATION COURT

Mary Henderson Risk*

Like the student of law, the student of family life has learned to rely upon individual cases for his materials, to require as complete a statement of facts as it is possible to get, and to draw conclusions as to underlying principles cautiously and with ample footnotes for exceptions. The law offers an extensive case literature; but family case histories are for the most part restricted to the records of relief organizations, whose cases are biased by their common characteristic of dependency. Most efforts to secure more representative samples have been handicapped by the tradition of privacy in family affairs.

A series of case records which are unusually valuable for the study of economic characteristics of certain families has been recently made available by the establishment of the Conciliation Division in the Common Pleas Court of the City of Detroit, Michigan.[1] The principal function of the Division is to facilitate partial payments by employee debtors on judgments granted by the Court. The debtor discloses the amount of his wages, his financial condition, and the number of his dependents. The record of payments through the Conciliation Division identifies periods of employment and unemployment. Testimony at hearings on debtors' motions frequently adds valuable supplementary information. This testimony, however, is not reported by the Division and it can be had only by attending sessions of the Court.

The purpose of this article is to present a group of cases involving instalment purchase contracts which were heard in the Conciliation Division between January 18 and January 28, 1935. Although these cases tend to illustrate some of the abuses to which instalment selling and financing have been subject and some of the hazards which the deferred payment system has added to family life, they are inadequate evidence upon which to base an appraisal of the system itself. Instalment selling defies nice generalizations concerning its influence as a social institution. It is but one of the many influences which impinge upon modern family life, and its consequences cannot be isolated completely from those of other forces. Also, the effect

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[1] For a description of this court, see Nugent, *Devices for Liquidating Small Claims in Detroit*, *supra*, p. 259, at p. 260.

of an identical set of influences upon individual families is in large degree unpredictable. Like the individuals who compose it, the family has temperament, prejudices, aptitudes, and ineptitudes, and what is one family's meat is another's poison.

The reader will recognize promptly that all of the cases presented here have other common characteristics beside the criterion by which they were selected. All cases involve defaulted contracts, since default is necessary to provide the creditor with a right of action. All cases, also, have a common *locale*. Plaintiffs and defendants live or do business in Detroit or its environs. Whether or not they are directly associated with the automobile industry, the fortunes of both parties are affected in large measure by the course of automobile production. Further, the relationships of debtor and creditor are governed in each case by Michigan law. Consequently, these cases tend to demonstrate the impact of instalment contracts upon defaulting families in a city dominated by a seasonal industry, and in a state whose garnishment law is unusually severe for the debtor.

During the period covered by our study of the Conciliation Division, hearings were held on approximately 275 cases. Many of these hearings took but a few seconds to complete and the process was so rapid that it was frequently impossible for a reporter to identify even the case numbers. In 150 hearings, however, it was possible to identify the case number and to record oral testimony. This record was then supplemented after adjournment of the court by examining the docket and the clerk's record. As far as the employment of the debtor and the nature of the debt were concerned, the hearings reported appeared to be representative of those listed on the docket.

Among our 150 cases, 71 involved instalment purchase contracts. Of the plaintiffs holding instalment contracts, jewelers and clothing companies were the most numerous. Automobile finance companies, furniture stores and radio shops were the next in order. Both in our sample and among all the outstanding cases on which partial payments were being made through the Division, a small number of creditors were the plaintiffs in the majority of cases.

The 25 cases presented here were selected solely because they furnished the most complete record. There has been no effort to make them representative either of kinds of creditors or of specific problems and abuses in the instalment purchase system, but by accident they are not untypical in these regards. The basis of selection tends, however, to introduce an element of bias. The hearings which produced the least verbal evidence and were disposed of in the shortest time were generally the simplest cases. Cases in which the Court paused to ask questions were generally those in which the practices of the creditor or the sincerity of the debtor were questionable. Our sample tends, therefore, to exclude cases in which the debt was acknowledged and payments were completed without difficulty.

Beyond this, the cases speak for themselves:

Case Number 1.

The plaintiff, an instalment clothing company, took a judgment for $64.50, in September, 1932, against the defendant, an employee of an automobile manufacturing company. Except for brief periods when he was laid off, the defendant made regular payments to the plaintiff during the nine months which followed. He was still afraid of garnishment, however, and in July, 1933, he arranged for partial payments through the Conciliation Division. Thereafter he made regular payments through the Division when he was employed. But he worked only part of the time during 1934, and while he was laid off the plaintiff had the file released.

In January, 1935, the defendant was rehired, and his wife came to Court to have his motion for partial payments reinstated. She reported that her husband's bi-weekly wage was $50, and that they owed four other delinquent debts: $10 for electricity, $50 to a doctor, $55 to a department store, and $300 for delinquent rent. She said she had eight children. Since she appeared to be about twenty-eight years old, the court questioned her truthfulness. To corroborate her statement she recalled several stories concerning her age and her children which had appeared in local newspapers. The Court remembered them.

Since the balance due on the judgment was only $6, she arranged to eliminate the debt by two bi-weekly payments.

Case Number 2.

The plaintiffs, an industrial bank and an automobile finance company, had taken judgments against the defendant, an employee of an automobile manufacturing company. The industrial bank had taken judgment in September, 1933, for $147; and the automobile finance company in December, 1933, for $108.45, which represented the balance claimed by the finance company as a deficiency following the repossession and sale of a used car which the defendant had bought in November, 1931. The plaintiff reported the account as follows:

Original unpaid balance		$275.40	(Nov. 30, 1931)
Cash payments	$ 21.95		
Sale of repossessed car	147.00		
Total credit		168.95	(March 7, 1932)
Deficiency		$106.45	
Court costs		2.00	
Judgment		$108.45	(Dec. 30, 1933)

The first hearings for partial payments on these judgments were not held until May, 1934. At that time the defendant was being paid $40 every two weeks. Payments were fixed at $2 bi-weekly on each judgment. The court reduced his payment to $1 on the next payday because the defendant received only $15. The defendant

made payments of $2 on each account on June 12 and June 27. On the next payday, July 9, he was laid off and payments were suspended.

The defendant was rehired in January, 1935, at an average bi-weekly wage of $50. Immediately thereafter he applied to have his motion reinstated. He was a native American, about thirty years old. He was well dressed and seemed ashamed that it was necessary to settle his affairs in court. He said he had a wife and four children, and was also supporting his father. The Court increased his bi-weekly payments to $2.50 on each judgment. The attorney for the instalment finance company objected that this was too little, but the Court refused to require larger payments.

Case Number 3.

The plaintiff was an instalment jewelry company; the defendant, a colored man, employed by a manufacturer of automobile bodies. Early in 1934, when the defendant was working steadily, a salesman for the plaintiff was selling jewelry at the factory gate each evening. Although the defendant was solicited regularly, he refused to buy anything. Finally, the salesman followed the defendant home one night and succeeded in selling him a watch for $35 and a chain for $5. The defendant made no down payment but contracted to pay $2.99 a month.

After the salesman had left, the defendant discovered that the watch had been used. He forced the company to exchange it for a new one. After paying $2 on the account, he went to a reputable jeweler and discovered that the chain for which he had paid $5 was worth only $1.75 at retail. He refused to pay any more, and in May, 1934, the jewelry company obtained a judgment for $38 and $2 court costs. Because the defendant was laid off shortly after the judgment was taken, no garnishment was issued. The defendant had a wife and six children, and the family was supported by welfare relief until October, when the defendant obtained part-time employment. The plaintiff did not garnishee the defendant's wages until January, 1935, when the defendant began to work full time. The plaintiff garnisheed and recovered $15.14, of which $5.50 represented court costs, from the defendant's bi-weekly wages of $37.84.

This garnishment brought the defendant into the Conciliation Division to arrange for partial payments. At the hearing the defendant resented having to pay much more than the watch was worth. The defendant said he would not mind so much if it were not that the plaintiff's salesman still solicited business at the factory gate.

He said he also owed $23 to an instalment clothing company, $9 to an instalment department store, and $17 to an instalment furniture company. None of these creditors had taken judgment.

The Court was inclined to agree with the defendant's opinion of the plaintiff. But the defendant had bought the merchandise, and a judgment had been awarded to the plaintiff. Because of the circumstances, the Court limited the payment to $2 bi-weekly. If the plaintiff should object and no other judgment should be taken, the

rate of payment would have to be raised to the full 10 per cent of the defendant's wages. The Court again requested that the plaintiff's salesmen modify their tactics.

Case Number 4.

The defendant, a negro employee of a brass company, had bought a ring from the plaintiff, an instalment jeweler. The defendant said that he tried later to return the ring, but the plaintiff would not accept it. The plaintiff brought suit and obtained a judgment. Shortly afterward the defendant arranged for partial payments through the Conciliation Division. He was then making $12 a week. He had a wife and two children, and he reported one other debt of $20 due to a credit clothing company. Payments were fixed by the Court at $1 a week. Twenty dollars was paid in this manner, but the defendant failed to pay on three occasions, so the plaintiff had the motion vacated, and collected $16.80 by means of three garnishments. Only $6.30 of this sum was credited to the account; the balance of $10.50 was court costs.

This hearing was held at the request of the defendant and the agreement to pay $1 a week through the Conciliation Division was reinstated.

Case Number 5.

The plaintiff, an instalment jeweler, took a judgment for $100.29, including $2 costs, against an employee of a company manufacturing automobile parts. The defendant's wife, a pretty, well-dressed woman of twenty-six, came to the Conciliation Division to find out what she could do about the judgment. Her husband was working only part time and was being paid $20 bi-weekly. She said she had two children and that her husband owed, in addition to the judgment, $24 to a department store, $118 to a furniture store, and $120 to a small loan company. Her husband owed the plaintiff for a diamond ring which she was wearing. She asked the court whether the ring was worth the purchase price of $100.

The Court had the ring appraised by a reputable jeweler who said it had cost $15 wholesale. The defendant's wife was told that it was unfortunate that she had not obtained this information sooner and contested the amount of the judgment. Since an appeal would be expensive, she was advised to pay the debt. She agreed and arranged to make payments of $2 bi-weekly through the Conciliation Division.

At the hearing the Court told the plaintiff that he would like to see the case appealed, and that if he found such a case where the defendant could afford it he would suggest that an appeal be made. The plaintiff's defense was that the defendant was guilty of conversion because he gave the ring to his wife, contrary to the sales agreement.

Case Number 6.

The plaintiff, an instalment jewelry company, took a judgment against a colored man who had been employed for two years by a brass company. The defendant said that the debt was for a $42 watch which he bought just outside the factory

from the plaintiff's salesman. He said further that he had paid about $20 on the watch before he defaulted. The plaintiff took a judgment against him for $31 in August, 1934. Following the judgment, the defendant arranged for partial payments. His employer reported that the defendant's average weekly check was $13.40 and that he frequently "lays off one or two days on own accord." But the defendant made no payments through the Conciliation Division because a few days after he made the motion he was laid off. He went on welfare relief until January, 1935, when he was rehired at $24 a week.

At this rehearing the defendant appeared in a worn and shoddy coat. He said that, in addition to the judgment, he owed three or four instalment clothing companies and a bill for room and board. Most of the $28 he received on January 25 had been paid toward his room and board bill and, although this hearing was held only three days after his payday, he now did not have a cent. The motion was granted. The first payment was to be made promptly on the following payday.

Case Number 7.

Three plaintiffs, an industrial bank and two instalment jewelry companies, had taken judgments against the defendant, a street-car motorman. The defendant was represented at this hearing by his wife, a young, native-American woman. She said she had two children and that her husband earned $40 bi-weekly.

The defendant had borrowed from the industrial bank and had bought the jewelry while he was working. But he had been laid off before he repaid these contracts. The defendant's wife said he had been working for the street railway for six and one-half years, that he had been laid off for three months during 1934, and that he would have to work five and one-half years longer before he would not be subject to lay-off.

The defendant's wife arranged to pay $1.50 bi-weekly on each judgment. The defendant had a fourth judgment already in the Conciliation Division and the payment on that one was reduced to $1.50.

Case Number 8.

The plaintiff was an instalment clothing company. The defendant was employed by a laundry. On October 4, 1934, the defendant bought his wife a coat and purse from the plaintiff. Two days later he lost his job. He had work during the month of November, and made some payments on the account. But he was laid off again during December and January, and was supported by welfare relief. His wife supplemented this allowance by earnings from two or three days' work each week.

On January 24, the defendant's wife, greatly agitated, came into the Conciliation Division. She had paid the plaintiff $3.50 on January 5. Although the plaintiff had recorded this payment of $3.50 in her account book, he had refused to subtract more than $1.50 from the balance due. In examining her account the Court found that the plaintiff had taken a judgment in December for $25.49, representing a balance

due of $23.49 and $2 costs. In January, however, the plaintiff had taken the court costs out of the defendant's $3.50 payment and refused to credit it to the account. The record of the account follows:

Cost of purchase	$32.17		(Oct. 4, 1934)
Paid—68 cents down, $1 instalments	8.68		
Amount due and sued for	$23.49		(Dec., 1934)
Amount of judgment		$25.49	
Paid and marked on book	3.50		(Jan. 5, 1935)
Balance due on judgment—shown as due to plaintiff		$21.99	(Jan. 24, 1935)
Correct balance due to plaintiff	$19.99		

The Court immediately telephoned the plaintiff's bookkeeper, explained that court costs had apparently been charged twice on this account and directed him to correct his books. The bookkeeper replied that the entry must have been an error, and that he would correct it at once.

When the defendant returns to wcrk he will arrange to make his payments through the Division.

Case Number 9.

The plaintiff, an instalment clothing company, had a judgment for $29.50 against the defendant, an employee of an automobile manufacturing company. Apparently the defendant made some payments directly to the plaintiff, and then in December, 1934, arranged for partial payments through the Conciliation Division. At the time of that hearing he reported that he was earning $35 bi-weekly, and that he had a wife and two children. He said he owed three other delinquent debts; $30 for rent, $45 for insurance, and $215 to a small loan company. His payment was fixed by the court, and he paid regularly.

By January, 1935, the defendant had repaid $15. But one night, at 11 p.m., he was aroused by a threatening "collect" telegram concerning the account. The telegram was signed by a detective agency, which, it was discovered, was not even listed in the telephone directory. A few days later the defendant reported this occurrence to the Conciliation Division. The Court told him not to worry. The plaintiff was notified to stop this practise and to credit the defendant with the cost of the wire because this use of a "collect" telegram was not legal.

Case Number 10.

The defendant, an employee of an automobile manufacturing company, had bought clothing from two instalment clothing companies several years before the date of this hearing. Both clothing companies went through bankruptcy, and the plaintiff, who had been associated with both companies, bought the accounts of each for 5 cents on the dollar. In May, 1934, the plaintiff sued the defendant for one of

these accounts and got a judgment for $35.50. In June the defendant arranged to make partial payments directly to the plaintiff.

The defendant made payments regularly when employed. When the amount of the judgment had been repaid, the plaintiff told him that his payments had been credited to the second account and that he must now pay on the judgment. On January 4 the defendant received no pay for the previous two weeks. His wife telephoned the plaintiff and was told to wait until he was paid. But before he received his next bi-weekly wages, the plaintiff garnisheed.

The defendant came to court to get the garnishment released and to arrange for partial payments through the Division. He was a neatly-dressed native American, about twenty-seven years old. He said his wife was about to have a baby, their second child. He could ill afford to lose time from work, and she would have represented him if it were not for her condition.

The plaintiff claimed that the defendant had arranged with him to pay off the open account first. The Court ruled that this use of the judgment as a lever was not allowable, and released the garnishment. The defendant paid $1.75 to the court in satisfaction of the judgment.

After the hearing the defendant said he had little confidence in the plaintiff, and he hoped the plaintiff would get a judgment for the other account so that he could pay through the Division. This would cost an additional $2 for the judgment, but he knew he would receive fair treatment in the court. The defendant also was wondering whether, after the dispute, the plaintiff would credit him with $7.05 which he had paid the company but for which he had no receipts.

Case Number 11.

The plaintiff, an automobile finance company, had a judgment for $177 against the defendant, who had been employed in the same automobile manufacturing company's plant for two years. Early in 1934, when the defendant was working steadily, he bought a second-hand car. He had the car just seven months. In the summer he was laid off and could no longer continue his payments. He returned the car and signed a repossession. He had no work until January, 1935. As soon as he was reëmployed the finance company took a deficiency judgment for the balance due and garnisheed his first pay. As a result of the garnishment action he was discharged.

The defendant was greatly excited when he came into the Division. He was a thin young American. He said he had a wife and three children, and that he had never had any previous dealings with the law. He gratefully obtained a letter to his employer, in which the Court stated that garnishment would not happen again as the bearer would make partial payments through the Division and pay off this bill.

While he was waiting for the letter he said that the amount of the judgment seemed very large to him. After the repossession of the car the debt was only $15 less

than the amount he had originally owed the finance company. Of course there were interest charges, and the car apparently was resold for a small sum.

The following day the defendant returned to the court to say that the letter had done very little good. His employer had said that there might be a place for him after a month or six weeks. He wandered aimlessly around the court room for about an hour, as if he did not know what to do next. Finally, appearing completely dejected, he walked out of the Division.

When he is reëmployed he will have to have his motion reinstated and start making payments.

Case Number 12.

In December, 1934, the plaintiff, an instalment finance company, had taken a judgment for $40 against the defendant, a thirty-five-year-old colored employee of a rubber goods manufacturing company. The debt was for a deficiency resulting from the repossession and sale of a second-hand car which the plaintiff had financed.

The defendant had reduced the judgment to $27 by instalment payments to the plaintiff. But in January, 1935, he came to the Conciliation Division to arrange a motion for partial payments. He was greatly excited. Although he was wearing a ragged coat, he said he had property, and was afraid that the plaintiff would attach it. The "property" was a 1934 Studebaker which he was buying on the instalment plan. His payments were up-to-date, but he still owed $800.

He said he was receiving $45 bi-weekly and that his last pay was $54.70. He stated that he was paying off his other old debts, but still owed a balance of $17 for rent and a similar amount for groceries. He had a wife and one child.

He arranged to pay the judgment through the Division, which would prevent garnishment but would not interfere with a property execution.

Case Number 13.

The plaintiff, an instalment furniture company, had taken a judgment against the defendant, who was employed by a bakery. After the judgment was taken, the defendant made regular payments to the plaintiff. In January, 1935, his wages were cut from $29 to $21 a week, and he applied to the plaintiff to have his rate of payment reduced. The plaintiff refused and threatened to attach the defendant's furniture.

The defendant's wife, a neatly-dressed woman about thirty years old, came to the Conciliation Division. By questioning her the Court discovered that the defendant had two accounts with the furniture company. The company had taken judgment for the balance due on the first account and was entitled to repossess only the furniture—a very small proportion of the total—bought on the second account. The defendant's wife was advised to let the plaintiff take the furniture, but to be sure that he made no mistake and removed some pieces bought on the first account.

Before leaving the Division, the defendant's wife made a motion for partial payment to prevent a garnishment being issued on the judgment.

Case Number 14.

In March, 1934, the plaintiff, an instalment furniture company, had obtained a judgment for $86 against the defendant, an employee of an automobile body manufacturer. At that time, the defendant's employer reported his average earnings to be $32 bi-weekly. Payments were fixed by the Conciliation Division, and from April 6 to August 31 the defendant paid $3 bi-weekly on the account. Contrary to the usual practice, when he received a "short" pay he did not seek a reduction in his payment, but asked for a suspension and then doubled his next payment. He was laid off in September, but returned to work in November. His employer reported that he was averaging $45 bi-weekly. His motion for partial payments was reinstated and his rate of payment set at $4. He paid regularly, but his two January checks were for $30 each, and he paid only $3 on these paydays.

The case was reopened at the request of the wife of the defendant. She was about twenty-eight years old and pleasant-appearing in spite of a profusion of curls, gold teeth, and a veil. She reported that they owed the plaintiff $80 on another furniture account, and that repossession of both sets of furniture had been threatened because the second account had not been paid. In addition to sustaining two children, they had reduced their debts between April and December as follows:

	Furniture No. 1 (judgment)	*Furniture No. 2*	*Groceries*	*Rent*	*Doctor*
April	$86	$83	$50	$60	$16
December	40	80	25	60	16

The defendant expected larger pay-checks in February, and his wife offered to pay $5 every two weeks, in addition to making up the $2 which she had not paid during the preceding "short" weeks, if the Court would assure her that their furniture would not be removed. She was told to continue the payments as previously agreed. The Court telephoned the plaintiff, told him that she was paying regularly through the Division, and asked him to wait until the judgment was paid off before he attempted to collect on the second account. The plaintiff's representative replied that there must have been some mistake, and that the company would neither threaten her again nor take her furniture.

Case Number 15.

The defendant, who was employed by an automobile manufacturing company, had made a purchase from the plaintiff, an instalment furniture company. The defendant had a wife and five children. He was laid off in September, 1934, and he went on the welfare roll. His payments were defaulted, and in December, 1934, the plaintiff took a judgment for $32.

The defendant was rehired in January, 1935, at an average bi-weekly wage of $42. A week after he went back to work he came into the Division to arrange for partial

payments. He reported other debts of $35 for groceries, and $20 for gas and electricity.

At the hearing he was particularly worried by the amount of the judgment. Apparently he had made two purchases from the furniture company on the same account. He said he owed the furniture company more than $32 and was afraid that, in spite of his payments through the Division, they would remove his furniture. The Court told him that they might do so—that they probably had a legal right to take the furniture—but that if the company tried it or threatened it, while he was making regular payments, he should come back to the Division, and the Court would try to prevent it.

The motion for partial payments was granted.

Case Number 16.

On January 4, 1935, the plaintiff, a shop selling electrical goods on the instalment plan, took a judgment for $54.40 against an employee of an automobile manufacturing company. In January, 1934, the defendant was working steadily, and a salesman friend persuaded him, in spite of his wife's objections, to buy a $124 radio from the plaintiff. He paid $21 down and $7.80 a month until he was laid off in the early summer. He had some work in the fall but did not make any payments on the radio because of unforseen medical expenses—one of their children had an abscess. He returned to regular work in December, 1934, at an average wage of $60 bi-weekly.

When the judgment was taken the defendant was working in the day time, so his wife attended to the matter. She was most perplexed by the amount of the judgment, $54.40, because she figured her balance due to be $60.18. The total of her bill was $127.18—the $3.18 was for repairs—and they had paid $67. She went to the shop and pointed out their error. They informed her that she was correct but that they had taken the judgment for less than the full balance so that they could still take the radio back even after they had garnisheed her husband's wages several times. They had taken their judgment for the balance due as of the date of judgment and one monthly payment was not yet due.

She did not understand this and appeared in the Division for her hearing wondering whether the shop could do this if she paid through the Division. The Court told her that the shop could legally replevin the radio whether she paid through the Division or not, but that if she would pay $6 through the court each payday he would attend to the matter. He requested the shop over the telephone, not to take the radio or threaten her while the payments were continued, and told her to return to the Division immediately if they did either.

She was very neat, white, apparently American-born and about twenty-eight years old. After her worry was settled she smiled delightfully, and said that she had four children and owed, in addition to the radio debt, $33 to the doctor, $15 on a loan, and $57 on her furniture.

Case Number 17.

The plaintiff, an instalment department store, took a judgment for $36.40 for merchandise against the defendant, who was employed in an automobile manufacturing company's plant. The plaintiff garnisheed the defendant's wages twice. As a result of these actions, the defendant made a motion for partial payments. The defendant said his wage was $53.50 every two weeks. He did not mention unemployment, but claimed to be supporting his brother and sister. He reported three other unpaid debts totaling $580.

At the hearing he arranged to pay $5 each payday on this debt, and stated that the reason for his having to arrange the matter through the Division was that the plaintiff had refused to accept $5 bi-weekly payments from him when he offered to settle directly.

Case Number 18.

The plaintiff, an instalment finance company, had taken a judgment for $171 against the defendant, a forty-year-old street-car motorman. The defendant was paid $60 bi-weekly. He had a wife and six children. He had just been through bankruptcy, but reported that he owed, in addition to the finance company's judgment, $202, $187, and $157, respectively, to three instalment furniture companies. He was paying $2 a week on one account and $3 a week on the other two.

Following his bankruptcy, and while he was paying the furniture companies, the defendant purchased an electric refrigerator for $182 and agreed to pay the plaintiff company, which financed the sale, at the rate of $14 a week. He defaulted almost immediately and as a result the judgment was taken. There was no evidence that he had been unemployed.

At the hearing the Court reprimanded the defendant for making such a purchase while still so heavily in debt and after going through bankruptcy. His only reply was that his wife had insisted she had to have the refrigerator. The motion was granted, and the defendant made his first payment on the day of the hearing.

Case Number 19.

A carpet company, selling on the instalment plan principally to negroes, was the plaintiff in this action to collect $25.19 from a colored employee of an automobile body manufacturing company. The defendant bought a carpet from the plaintiff in April, 1934, for $31.75, making a down payment of $2.15. He paid $8.91 on the account during the next few weeks, but failed to continue his payments thereafter. In August, the carpet company took judgment for the debt and proceeded to garnishee his wages. Garnishment was unsuccessful because the defendant had been laid off, which probably also accounted for his failure to make payments. Between August and December, however, the defendant paid $2 additional on the account.

The defendant was reëmployed in December, and by agreement with the carpet company used his first pay to reduce his debt to his landlord. He said he promised

to pay the company something on his second payday. But before he received his second pay, the carpet company garnisheed. The company received $7.26 of $18.15 due to the defendant for services. Of the $7.26, however, $2.50 represented cost of garnishment. At the date of the hearing the account stood as follows:

Purchase price	$31.75	Down payment	$ 2.15
Interest to date	1.39	Payments	10.91
Court costs	4.50	Garnishment	7.26
	$37.64		$20.32

Balance due—$17.32.

The motion was granted.

Case Number 20.

Two plaintiffs, an industrial bank and an instalment carpet company, had taken judgments in August and December, 1934, respectively, against the defendant, a colored employee of an automobile manufacturer. In January, 1935, the defendant made a motion for partial payments on both judgments. The defendant knew that his employer's policy was to discharge an employee for having a garnishment action, but he did not appear for his hearings. The bank's attorney was present. The Court started to dismiss the motions. But the attorney asked for a delay; saying to wait, that he remembered the defendant and would like to give him a chance. The Court consented and told him to be sure to notify the defendant immediately, for the other plaintiff's policy was always to garnishee.

Case Number 21.

Three plaintiffs, two grocers and an instalment carpet company, obtained judgments in March, 1934, for $81, $40, and $34, respectively, against the defendant, who was an old colored man employed by the city. Within the same month the defendant arranged for partial payments of $1 a week on each of these three judgments. Although he was employed, he did not pay regularly. In October the fourth plaintiff, an instalment clothing company, obtained judgment against the defendant. In January, 1935, the fifth plaintiff, an instalment jewelry company, took a judgment against the defendant. Meanwhile, the motions for partial payments on the first three judgments had been vacated because of the irregularity of the defendant's payments.

At the present hearing, in January, 1935, the defendant appeared, wearing ragged clothes. He reported that he had a wife and four children, and that his wage was $33.75 a week. He had brought the two grocers' judgments for reinstatement, and made new motions on the instalment clothing and jewelry companies' judgments. The defendant failed to remember the judgment of the carpet company.

The Court fixed payments at $1 a week on each judgment, and admonished the grocer who was present at the hearing to garnishee in the event the defendant de-

faulted on any payment. The Court severely reprimanded the defendant for purchasing jewelry when still owing so many other debts. The Court's last words to the defendant directed him to arrange immediately for the reinstatement of the carpet company's judgment.

A week later the defendant reappeared to have the carpet company's judgment reinstated. He said he had not done this before because he had talked to this plaintiff and had promised to pay something each week direct. The defendant admitted that this debt was eight years old.

Case Number 22.

The plaintiff was an instalment jeweler who, in 1933, had sold a $57 watch to the defendant, a colored man employed by an automobile manufacturing company. The defendant was thirty years old and had a wife and two children. He was unemployed for several months in the latter part of 1933 and defaulted his payments. The jeweler obtained judgment for $49 in March, 1934. A hearing was held to arrange partial payments on the judgment. The borrower's wage then averaged $50 each bi-weekly period. Payments on the judgment were fixed at $5 to be made on each payday. In this manner the defendant reduced the judgment to $34. Subsequently, in the summer of 1934, he was laid off again, and payments were suspended. He was reëmployed in January, 1935. The present hearing was held to reinstate his payments.

In March, 1934, he had reported that, in addition to the judgment, he owed $36 to another credit jeweler, and $10 and $30 to two instalment clothing companies. In January, 1935, he said that the debt to the second instalment clothing company was now $36, that he owed $65 for delinquent rent and several other debts. The Court chided him upon his numerous credit purchases and pointed out that the cost of credit was necessarily included in the price. The defendant replied that he should not have bought the jewelry, but that it was impossible for any colored person to buy clothing except on credit. He was trying to pay $5 every two weeks on the largest clothing account and $4 bi-weekly on the debt for rent. He said he just couldn't save, and that he had only four and one-half months' work last year. He was always trying to pay all his delinquent bills, but managed only to pay some of his current expenses.

The motion was reinstated at the previous rate of payment.

Case Number 23.

Two plaintiffs, an instalment jewelry company and an instalment department store, had taken judgments in May and September, 1934, respectively, against the defendant, a colored man employed by a local branch of a nation-wide business. In January, 1935, the defendant made motions for partial payments.

At this hearing the defendant said that both the plaintiffs and two other creditors, another instalment jeweler, and an instalment furniture company, had all garnisheed

his wages. He reported that he worked on a piece-work basis and his earnings averaged $20 a week. The week before last a garnishment had taken $8 out of his $20 pay. Last week his pay was but $10, of which $4 was taken by a garnishment.

He arranged to pay $1.50 a week on each judgment, beginning the following payday. He was urged to arrange partial payments on the other two judgments.

Case Number 24.

The plaintiff, an instalment jewelry company, took a judgment against the defendant, a Polish employee who had worked twelve years for an automobile manufacturing company. About the same time the defendant received a letter from an instalment clothing company threatening a suit for an account.

The defendant's wife came into court. She could speak very little English, but spoke in Polish with one of the court clerks. She made a motion for partial payments on the judgment, and was told to go to the clothing company and offer to make payments directly to them to avoid a second judgment.

Case Number 25.

The two plaintiffs were instalment merchants: a carpet company and a department store. The defendant was employed by a rubber company. He was a colored man about twenty-five years old, and appeared in court in a bright green sweater. He said he had left Georgia in 1931 and worked for an Akron rubber company for a year. In 1932 he heard through a relative of a job which he now holds. He went to Detroit, got the job, and worked steadily. His average wage was $42 bi-weekly. He was married in 1933 and now has one child.

In June, 1934, he bought window curtains and rugs from the first plaintiff. He made some irregular payments on the account and then defaulted. The carpet company took a judgment for $46 in August. In December, 1934, he bought some clothing from the second plaintiff. He defaulted on his payments and the department store took a judgment for $46 the same month.

In the meantime an instalment clothing company had twice sent a salesman to the defendant's home to solicit business. On January 5, 1935, in spite of the two judgments, he made the following purchases:

Man's gloves	$ 1.98
" hat	3.98
" necktie	1.00
" underwear	1.49
" pair of shoes	5.95
Lady's blue dress	12.98
" underwear	1.96
Sales tax	.95
Total	$30.29

He paid 88 cents down and promised to pay $3 a week. He said that so far he had paid the company only $2 which he did on January 10. He was wearing the hat, necktie, and shoes. The hat was probably worth 98 cents; the necktie, badly frayed; and the shoes seemed as if a good rain would reduce them to pulp.

Shortly after he made this purchase the department store garnisheed his wages. The carpet company did not garnishee, but told him to arrange for partial payments through the Division. He came into the Division to make motions on both judgments. He did not mention his recent purchase of clothing until the Court asked him if he owed anything to certain specific clothing companies. Whether he had any other debts was not determined.

His motions were granted.

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